

(Updated)



LATEST  
VERSION  
3/28/07

**City of San Jose**

**ACTUARIAL VALUATION OF RETIREE HEALTH BENEFITS**

**AS OF JUNE 30, 2006**

## **TABLE OF CONTENTS**

Accounting for Other Postemployment Benefits.....	4
Comments.....	5
Summary of Benefit Provisions Evaluated.....	9
Summary of Actuarial Assumptions and Methods.....	11
Summary of Valuation Results.....	20
Sensitivity Analysis .....	22
Projections of Benefits Paid .....	23
Participant Summary .....	24
Definitions of Technical Terms .....	28

February 28, 2007

(Updated Report)

Mr. Edward Overton and Mr. Thomas Webster  
Department of Retirement Services  
1737 N. First Street, Suite 580  
San Jose, CA 95112-4505

Dear Ed and Tom:

Submitted in this report are the expanded results of an Actuarial Valuation as of June 30, 2006 of the benefit values associated with the employer financed retiree health benefits provided by the City of San Jose.

The valuation was based upon information furnished by the Employer concerning retiree health benefits and individual employees. Data was checked for internal consistency but was not otherwise audited.

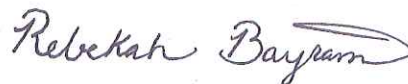
To the best of our knowledge this report is complete and accurate and was made in accordance with generally recognized actuarial methods. In our judgment the actuarial assumptions used for the valuation are, individually and in the aggregate, reasonable.

Respectfully submitted,

Gabriel, Roeder, Smith and Company



Rick A. Roeder, EA, FSA, MAAA



Rebekah D. Bayram, EA, FSA, MAAA

**City of San Jose**  
**Accounting for Other Postemployment Benefits**

June 30, 2006

The Government Accounting Standards Board (GASB) recently finalized two new accounting statements applicable to Other Postemployment Benefits, or OPEB plans. OPEBs are non-pension benefits provided after employment, and include the benefits valued in this report. One of the accounting statements relates to sponsors of OPEB plans while the other is applicable to the OPEB plan itself.

The GASB statements require that the long-term cost of retiree health care and other OPEB benefits be determined and accrued on an actuarial basis similar to pension plans. The results of these valuations, including an annual OPEB expense, have to be disclosed on the Employer's financial statements. Effective dates for the GASB statements are shown in the table below.

The GASB statements allow for several actuarial cost methods to be used when calculating the Plan's annual expense. We have used the projected unit credit method with amortization of unfunded accrued liabilities over both 30 and 11 years to illustrate the potential annual accounting expense that may have to be booked after the effective date under the GASB statements.

It is important to note that the GASB statement does not mandate the *pre-funding* of OPEB liabilities, only how one accounts for those benefits. However, any pre-funding of OPEB benefits at an amount less than the annual expense required to be reported by GASB would produce a positive net OPEB obligation. This net OPEB obligation would be required to be disclosed on the financial statements and may have a detrimental impact on the Employer's perceived financial health.

**GASB Statement Effective Dates**

Total Annual Revenues of the Sole or Largest Participating Employer in the Plan in the First Fiscal Year Ending After June 15, 1999	GASB Statement 45 will be Effective for that <i>Employer</i> for Periods Beginning After	GASB Statement 43 will be Effective for that <i>Plan</i> for Periods Beginning After
\$100 million or more	December 15, 2006	December 15, 2005
\$10 million or more, but less than \$100 million	December 15, 2007	December 15, 2006
Less than \$10 million	December 15, 2008	December 15, 2007



**City of San Jose**  
**Retiree Health Benefits**  
June 30, 2006

**COMMENTS**

**COMMENT A:** GRS issued an initial report last September. Subsequently, there have been two meetings where different actuaries, Board members and staff shared their views on assumption setting to resolve some of the inevitable differences in assumption setting by Segal and GRS. As a result of these meetings, we were requested to the actuarial results for three additional scenarios to reflect some of the collective input received.

We have completed additional work using a 5.6% discount rate. This was a suggested rate which reflects both a relatively low degree of existing Plan assets and the likelihood that the City will not desire to make a contribution for retiree medical contributions at least equal to the Annual Required Contribution. We have elected to retain much of the contents of our original report for the sake of continuity. **However, with such likelihood, it is important to focus on the numbers associated with the 5.6% discount rate.**

**COMMENT B:** Providing health care benefits to retired employees involves significant additional uncertainties when compared to paying pensions. The additional uncertainties include the rate at which medical costs will increase, changes in utilization, and changes in Medicare or other government regulations that result in higher Plan costs.

For many years the cost of providing medical services has been increasing more rapidly than costs in general. Each year in which that occurs the percentage that medical cost represents of all our goods and service increases. The chart below shows the percentage of Gross Domestic Product (GDP) that we, as a nation, spent on medical services for selected years.

<u>Year</u>	<u>% of GDP Spent on Health</u>
1950	4.3%
1960	5.1%
1970	7.1%
1980	8.9%
1990	12.1%
1995	13.6%
1996	13.6%
1997	13.4%
1998	13.5%
1999	13.9%
2000	14.3%
2001	14.1%
2002	14.9%
2003	15.3%

**City of San Jose**  
**Retiree Health Benefits**  
June 30, 2006

**COMMENTS**

During the last 40 years, general inflation averaged 4%, while health expenditures have increased at a significantly higher rate. On page 26, we show the medical care CPI over the last 40 years. If this trend is projected to continue for years to come, it implies that years from now virtually all our expenditures will be for health care – an impossible reality. The more reasonable alternative is to assume that medflation will moderate in the not-too-distant future. It is on this basis that we project premium rates increases will continue to exceed our long-term medflation assumption for the next 8 years, but by less each year until leveling off at the 4.00% ultimate general inflation assumption in the City's pension valuation.

Segal and GRS did not agree on the premise that long-term medflation will eventually moderate down to the level of general inflation over time. However, we did agree to do several additional costings where ultimate medical inflation grades down to 4.5% instead of the 4% ultimate trend rate in our initial reports. Such numbers are labeled "Higher Ultimate Trend."

**COMMENT C:** The Annual Required Contribution (ARC) is comprised of three components:

- 1) Normal cost -- measures cost of benefits accruing in current year for active employees
  - 2) Amortization -- a measure of financing the cost attributed to past service
  - 3) Adjusting element --to reflect difference between funding and expensing in previous years.
- This adjustment is not applicable in the first year the GASB statement is effective.

**COMMENT D:** The City determines the amortization period to use for GASB expensing, as long as the period does not exceed 30 years. While the City is not yet subject to GASB expensing rules under the new statement, earlier compliance is encouraged.

We have shown results under two scenarios using amortization periods of 30 and 11 years. We would characterize 30-year amortization as acceptable and understandable practice but not "best practice." Eleven years is the average future working lifetime of current active members. We have used a level-percent-of-pay approach in calculating the amortization factor. The City may wish to take a "transitional" approach by using the 30-year period since the initial transition to GASB compliance produces striking results.

We have used the same demographic assumptions as used in the Retirement System's most recent actuarial valuation. In our September work, we used the Projected Unit Credit funding method in our analysis instead of the Entry Age Normal funding method used by the City. The rationale again relates to pragmatic, transition issues. The City's outside auditor has expressed their satisfaction with either funding method. Some of our subsequent work has used the Entry Age Normal method.



**City of San Jose**  
**Retiree Health Benefits**  
June 30, 2006

**COMMENTS**

**COMMENT E:** In our **initial** study last September, using an 8.25% discount rate, we calculated the employer normal cost to be \$3,613,887 -- an average of \$949 for each of the 3,809 active members. There is an actuarial liability of \$443,313,512. Assuming plan assets of \$81,288,000, the related 30-year level-percent-of-pay amortization cost component is \$20,735,650. The ARC is the sum of normal cost plus amortization -- \$24,349,537.

11-year amortization would increase the amortization cost component from \$20,735,650 to \$40,692,068. The resulting ARC would be \$44,305,955 -- an 82% increase.

**COMMENT F:** The health care cost increase assumption anticipates that the rate of increase will be at moderate levels and decline over several years. Increases higher than assumed would bring larger liabilities and expensing requirements. Similarly, increases lower than assumed would generate reduced liability and expensing requirements. The Sensitivity Testing on page 22 of this report indicates that inflation 1% per year higher or lower results in roughly a 21% to 26% swing in the ARC.

**COMMENT G:** GASB Statement 45 requires implicit rate subsidies to be considered. An implicit rate subsidy occurs when the rates for retirees are the same as for actives. On a stand-alone basis, the retirant group will almost always be a "higher cost" group, per capita, than the active members due to their older ages. All future benefit payments need to be based on retiree (not active) claims costs, or age-adjusted premiums approximating claims costs. Page 19 shows the gross age-adjusted premiums.

For pre-age 65 retirants, we estimate the impact of such implicit subsidy to be \$1,551,337 for fiscal year ending 2007. This implicit treatment, which results in both higher expense and a contribution reallocation for retirants relative to adjusted cash flows, will result in a dollar-for-dollar expense offset for active members.

**COMMENT H:** The premium rate structure does not differentiate between coverage for one dependent and family coverage for multiple dependents. Per data received earlier this month from the City, we refined our approach to consider that the average number of covered dependents will be less for retirants than for current employees. If not for this refinement, the expense attributable to retirants would have been greater.

**COMMENT I:** Subsequent studies show significantly higher expense due to the use of lower discount rates and higher medical inflation. The summary of such expense is shown on page 23. For example, the impact on our initial study in lowering the discount rate and increasing ultimate medflation is to increase the calculated expense by 56%. The Annual Required Contribution would increase from \$24,349,537 to \$38,076,953.

**City of San Jose**

**Retiree Health Benefits**

June 30, 2006

**COMMENTS**

**COMMENT J:** This valuation was conducted under the general assumption that the system for delivering retiree healthcare benefits will continue unchanged. For the last decade, there have been changes to Medicare but the basic foundation of the program is still intact. On December 8, 2003 President Bush signed into law the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (aka Medicare Part D). In June 2006, GASB released Technical Bulletin 2006-1 *Accounting and Financial Reporting by Employers and OPEB plans for payments from the Federal Government Pursuant to the Retiree Drug Subsidy Provisions of Medicare Part D*. According to this Bulletin, Retiree Drug Subsidy (RDS) payments made to the plan are considered plan contributions. Measurement of actuarial liabilities and the ARC are not affected by RDS payments.

**COMMENT K:** The ARC is net of the employee contributions to retiree medical coverage. Staff indicated that these contributions are expected to continue in the future. We have reduced the normal cost component of Annual Required Contribution by the amount of anticipated employee contributions, net of refunds, 2.96% of payroll.

**COMMENT L:** One of the key assumptions used in any valuation of postretirement benefits is the rate of return on Plan assets. Higher assumed discount rates will reduce the ARC, other factors equal. Lower assumed discount rates will increase the ARC. As of June 30, 2006, the City has \$81,288,000 set aside to pay health benefits with an asset allocation assumed to earn a long-term return of 8.25% per annum. Under GASB, an 8.25% investment return may be used for accounting under GASB statements 43 and 45 if:

- 1) There is a formal, written employer's funding policy to contribute consistently an amount at least equal to the Annual Required Contribution ("ARC").
- 2) Such contributions to the plan are accumulated in an irrevocable trust or equivalent arrangement ("plan assets") through which benefits are paid for said OPEB benefits, and are creditor protected.

If the City does not contribute to the plan as outlined above, a lower discount rate, such as 5.6%, is much more appropriate. **We can not justify the 8.25% discount rate if ANY of the above conditions are not met.**

**COMMENT M:** We did not receive an updated data file for deferred vested members as of June 30, 2006. Deferred vested data used for this valuation is from the June 30, 2005 pension valuation. We believe this approach will have a de minimus impact on valuation results.

**COMMENT N:** There were 138 members as of June 30, 2005 who terminated employment with a temporary status of "Leave of Absence" (LOA). Staff indicated that members with this status are eventually re-categorized depending on their situation: disability retirement, deferred retirement, return of contributions, etc. Staff indicated that a fairly low percentage would return to work. We were not given an updated list of LOA members as of June 30, 2006, but based on the data from the prior year, we consider the health liability for these members to be very small and did not include them in this valuation. This group was included in the 2005 pension valuation. This approach explains roughly half of the decline in the active members number count in the 2006 OPEB valuation relative to the 2005 pension valuation.



**City of San Jose**

**Summary of Post-employment Benefit Provisions Evaluated**

June 30, 2006

**A. Eligibility**

**MEDICAL**

Employees retiring (including deferred vested members) at age 55 with 15 years of service; or with a monthly pension equal to at least 37.5% of final average compensation.

Employees who become disabled and have a monthly pension equal to at least 37.5% of final average compensation.

Spouse/domestic partners of retired members who are qualified for medical are eligible to receive coverage if married and enrolled in one of the City's medical plans at the time of the member's retirement.

Dependent children under 19 years of age (24 if a full-time student) are eligible to receive coverage.

Surviving spouses/domestic partners/children of deceased members are eligible for coverage only if

- the employee has 15 years of service at the time of death or is entitled to a monthly pension of at least 37.5% of final compensation; and
- both the member and survivor are enrolled in a City medical insurance plan at the time of death; and
- the survivor will receive a monthly pension allowance.

**DENTAL**

Employees retiring or becoming disabled directly from City service must

- have 5 or more years of service; and
- is enrolled in one of the dental insurance plans sponsored by the City

Spouses/domestic partners/children are eligible to receive coverage if enrolled and married at the time of the member's retirement.

Surviving spouses/domestic partners/children of deceased members are eligible for coverage only if

- the employee has 5 years of service at the time of death; and
- both the member and survivor are enrolled in a City dental plan at the time of death; and
- the survivor will receive a monthly pension allowance.

**City of San Jose**  
**Summary of Post-employment Benefit Provisions Evaluated**

June 30, 2006

**B. Benefits**

**MEDICAL**

The Retirement System pays 100% of the premium for the lowest cost health plan available to active City employees. The member pays the difference if another plan is elected.

Effective January 1, 2006 the lowest cost health plan is Kaiser; family coverage is \$939.72 and single coverage is \$377.40 per month.

**DENTAL**

The Retirement System pays 100% of the dental insurance premiums.

**C. Retiree Premium Rates:** Monthly rates used for 2006 are shown below.

	Effective January 1, 2006	
	<u>Single</u>	<u>Family</u>
<b>MEDICAL</b>		
<b>Non-Medicare Monthly Rates</b>		
Kaiser – Traditional (CA)	\$377.40	\$939.72
Blue Shield HMO	\$380.82	\$978.22
Blue Shield POS or PPO	\$563.58	\$1,448.32
<b>Supplemental Medicare Monthly Rate</b>		
Kaiser – Senior Advantage	\$342.08	\$684.16
Secure Horizons – Medicare + Choice	\$315.75	\$631.50
PacifiCare – Senior Supplement Plan F	\$257.00	\$514.00
Blue Shield – Medicare PPO	\$434.20	\$868.40
Blue Shield – Medicare HMO	\$284.84	\$569.68
<b>DENTAL</b>		
Delta Dental PPO	\$97.84	\$97.84
Delta Care PMI	\$50.10	\$50.10

**NOTE:** The summary of major plan provisions is designed to outline principal plan benefits. If the City should find the plan summary not in accordance with the actual provisions, the City should alert the actuary IMMEDIATELY so they can both be sure the proper provisions are valued.

Summary of Actuarial Assumptions and Methods

June 30, 2006

Basic Benefits. Normal cost and the allocation of benefit values between service rendered before and after the valuation date were determined using the projected unit credit cost method.

Financing of Unfunded Actuarial Liability. The unfunded actuarial liability was amortized by level percent of payroll contributions over 30 years, the maximum period allowed under the GASB standards. For comparison, we also present an amortization of 11 years, the average expected future working lifetime of active employees.

The expensing and benefit values of the Plan are calculated by applying actuarial assumptions to the benefit provisions and member information furnished, using the actuarial cost methods described above.

The principal areas of financial risk which require assumptions about future experiences are:

- (i) long-term rates of investment return to be generated by the assets of the Fund.
- (ii) patterns of future medical inflation rates.
- (iii) rates of mortality among actives, retirants, and beneficiaries.
- (iv) rates of withdrawal of active employees (without entitlement to a retirement benefit).
- (v) the age patterns of actual retirements.

In performing a valuation, the monetary effect of each assumption is calculated for as long as a present covered person survives -- a period of time which can be as long as a century.



## City of San Jose

### Summary of Actuarial Assumptions and Methods

June 30, 2006

Actual experience of the system will not coincide exactly with assumed experience, regardless of the choice of the assumptions, the skill of the actuary and the precision of the many calculations made. Each valuation provides a complete recalculation of assumed future experience and takes into account all past differences between assumed and actual experience. The result is a continual series of adjustments (usually small) to the computed expense. From time to time it becomes appropriate to modify one or more of the assumptions, to reflect experience trends (but not random year-to-year fluctuations).

The annual rate has been computed to remain relatively level from year to year so long as benefits and the basic experience and make-up of employees do not change. Examples of favorable experiences which would tend to reduce the amount expensed are:

- 1) Employee non-vested terminations at a higher rate than assumed.
- 2) Mortality among retirees and beneficiaries at a higher rate than indicated by our mortality assumptions.
- 3) Lower rates of medical inflation than assumed.
- 4) Actual retirement ages higher than assumed.

**City of San Jose**

**Summary of Actuarial Assumptions and Methods**

June 30, 2006

The Projected Unit Credit Actuarial Cost Method was used in conjunction with the following actuarial assumptions in the initial study. However, certain subsequent work does reflect the Entry Age Normal funding method.

The investment return rate used for the actuarial valuation is 8.25% per annum, compounded annually. This assumption is used to equate the value of payments due at different points in time.

The inflation rate used for the actuarial valuation calculations was 4.0% per year, compounded annually, the rate used in the City's pension valuation. It represents the difference between the investment return rate and the assumed real rate of return.

Assumed future medical inflation. The valuation assumes that future medical inflation will be at a rate of 12% per annum graded down each year in 1% increments to an ultimate rate of 4% in our initial study. For purposes of sensitivity testing, liabilities were also shown with an increase or decrease in rates of 1%. Dental inflation is assumed to be 6% graded down to 4% over a nine-year period. In certain subsequent study work, the assumed medical trend was assumed to never be lower than 4.5% and is labeled "Higher Ultimate Trend."

<u>Date of Increase</u>	<u>Assumed Medical Inflation</u>	<u>Assumed Dental Inflation</u>
12/31/2006	12.0%	6.0%
12/31/2007	11.0%	6.0%
12/31/2008	10.0%	5.5%
12/31/2009	9.0%	5.5%
12/31/2010	8.0%	5.0%
12/31/2011	7.0%	5.0%
12/31/2012	6.0%	4.5%
12/31/2013	5.0%	4.5%
12/31/2014 +	4.0% (or 4.5%)	4.0%

**City of San Jose**

**Summary of Actuarial Assumptions and Methods**

June 30, 2006

Compensation Increase Rates used to project current pays to those upon which a benefit will be based are represented by the following table. Rates do not vary by age, but do reflect an added merit component, for those with 0-4 years of service at the valuation date.

*Base Annual Rate of Compensation Increase*

Inflation	4.00%
Merit and Longevity	0.25%
Total	4.25%

*Additional merit component*

<u>Years of Service at Valuation Date</u>	<u>Merit/ Longevity</u>
0	5.50%
1	3.50%
2	2.00%
3	1.50%
4	0.75%



**City of San Jose**

**Summary of Actuarial Assumptions and Methods**

June 30, 2006

Rates of separation from active membership are shown below (rates do not include separation on account of retirement or death). This assumption measures the probabilities of members remaining in employment.

<u>Sample Ages</u>	<u>Disability<sup>1</sup></u>	<u>Withdrawal</u>	<u>Vested Termination</u>
20	.04%	11.00%	---%
25	.06	7.00	3.00
30	.07	5.00	3.00
35	.09	2.50	2.75
40	.15	1.50	2.00
45	.25	1.25	2.00
50	.40	1.25	1.50
55	.50	1.00	0.00
60	1.00	1.00	0.00
65	2.00	0.00	0.00
70	0.00	0.00	0.00

<sup>1</sup> 50% of the disabilities are assumed to be duty-related and 50% are assumed to be non-duty related.

For inactive members, the assumed age at retirement is age 58.

**City of San Jose**

**Summary of Actuarial Assumptions and Methods**

June 30, 2006

The post-retirement mortality table used for healthy retirees and beneficiaries was the 1994 Group Annuity Mortality Table (sex distinct). The disabled mortality table used was the 1981 Disability Mortality Table. This assumption is used to measure the probabilities of members dying after retirement and the probabilities of each benefit payment being made after retirement. Sample values are shown below.

<u>Sample Ages</u>	<b>Future Life Expectancy (Years)</b>			<b>% of Benefit Recipients Dying Each Year</b>		
	<u>Retired</u>			<u>Retired</u>		
	<u>Men</u>	<u>Women</u>	<u>Disabled</u>	<u>Men</u>	<u>Women</u>	<u>Disabled</u>
45	35.4	39.7	23.6	0.16%	0.10%	2.08%
50	30.7	34.9	21.1	0.26	0.14	2.44
55	26.2	30.2	18.7	0.44	0.23	2.84
60	21.8	25.6	16.4	0.80	0.44	3.30
65	17.8	21.3	14.1	1.45	0.86	3.79
70	14.3	17.3	11.7	2.37	1.37	4.37
75	11.1	13.6	9.2	3.72	2.27	5.53
80	8.4	10.3	7.0	6.20	3.94	8.74

The active member mortality assumption measures the probability of mortality before retirement. The rates include probability of ordinary death, service death, and death while eligible for retirement or disability.

**% of Active Members Dying Each Year**

<u>Sample Ages</u>	<u>Men</u>	<u>Women</u>
30	.06%	.05%
35	.06	.05
40	.07	.06
45	.09	.08
50	.16	.13
55	.26	.20
60	.38	.30
65	.53	.44

**City of San Jose**

**Summary of Actuarial Assumptions and Methods**

June 30, 2006

The rates of retirement used to measure the probability of eligible active members retiring during the next year.

<u>Retirement Ages</u>	<u>Percent of Active Members Retiring Within the Next Year<sup>1</sup></u>
55	15.0%
56	7.5
57	7.5
58	7.5
59	7.5
60	7.5%
61	7.5
62	20.0
63	10.0
64	10.0
65	25.0%
66	25.0
67	25.0
68	25.0
69	25.0
70	100.0

<sup>1</sup>Superseded by 50% retirement probability each year after completion of 30 years of service and attainment of age 50.



Summary of Actuarial Assumptions and Methods

June 30, 2006

**Additional Medical Assumptions**

The eligibility conditions for retiree medical coverage we used were after attainment of age 55 and 15 years of service at retirement, or a monthly pension equal to 37.5% of final average compensation. Deferred retirements and disabled retirements meeting this requirement are also eligible for medical coverage. The eligibility condition for medical coverage for future surviving spouses was assumed to be the active member's attainment of 15 years of service.

Participation in retiree medical plans: We assume 85% of future retirees meeting the eligibility conditions above will participate in the retiree medical plan.

The probability of electing spouse/domestic partner coverage at retirement was assumed to be 55% for future retirees, with males assumed to be three years older than their spouses, and females assumed three years younger. Also, 55% of active members dying in service are assumed to leave surviving spouses who elect medical coverage. 100% of surviving spouses of retired members are assumed to continue coverage.

**Additional Dental Assumptions**

The eligibility conditions for retiree dental coverage we used were after attainment of 5 years of service at retirement, or eligible for disabled retirement. Deferred retirements are not eligible for dental coverage. The eligibility condition for dental coverage for future surviving spouses was assumed to be the active member's attainment of 5 years of service.

Participation in retiree medical plans: We assume 100% of future retirees meeting the eligibility conditions above will participate in the retiree dental plan.

The probability of electing spouse/domestic partner coverage at retirement was assumed to be 65% for future retirees, with males assumed to be three years older than their spouses, and females assumed three years younger. Also, 65% of active members dying in service are assumed to leave surviving spouses who elect medical coverage. 100% of surviving spouses of retired members are assumed to continue coverage.

**City of San Jose**  
**Summary of Actuarial Assumptions and Methods**

June 30, 2006

Implicit Subsidy and Premium Development: Premium development is required for the two classes of retirees (pre-age 65 and post-age 65). These premiums were developed using fully-insured premium rates from the health plans offered in conjunction with census data for the active and retired participants of the City's medical benefit plan (see pages 25 and 26). These premium rates were adjusted to reflect the increase in utilization expected of an older population and the decrease in expected number of dependents covered under family coverage. In addition, these premium rates were adjusted to reflect differing utilization rates by age and sex. Sex-specific aging factors used reflect the expectation that women will have about the same per capita claims as men at age 57 years, have higher claims before age 57, and have lower claims after age 57. Gross imputed single coverage rates at sample ages are shown below.

The impact of the recently enacted Federal legislation creating a prescription drug benefit under Medicare has not been reflected in this report since the impact will affect contributions (in the form of *on-behalf contributions*), not liabilities of the plan (GASB Technical Bulletin 2006-1).

**Gross Imputed Single Coverage Monthly Premium Rates by Age**

Pre-Age 65 Retiree Rates			Post-Age 65 Retiree Rates		
<u>Age</u>	<u>Male</u>	<u>Female</u>	<u>Age</u>	<u>Male</u>	<u>Female</u>
55	\$473.77	\$486.99	65	\$335.48	\$308.93
60	595.19	572.10	70	386.97	347.96
64	692.77	642.13	75	429.60	381.26
			80	460.62	406.02

Dental Premium: Based on census data for current retiree dental plan participants (see page 25); we assumed 97% of future eligible retirees would choose Delta Dental PPO and 3% of future eligible retirees would choose Delta Care PMI. This produced a monthly dental premium rate of \$90.50.

**City of San Jose**

**Summary of Valuation Results in Original Valuation**

June 30, 2006

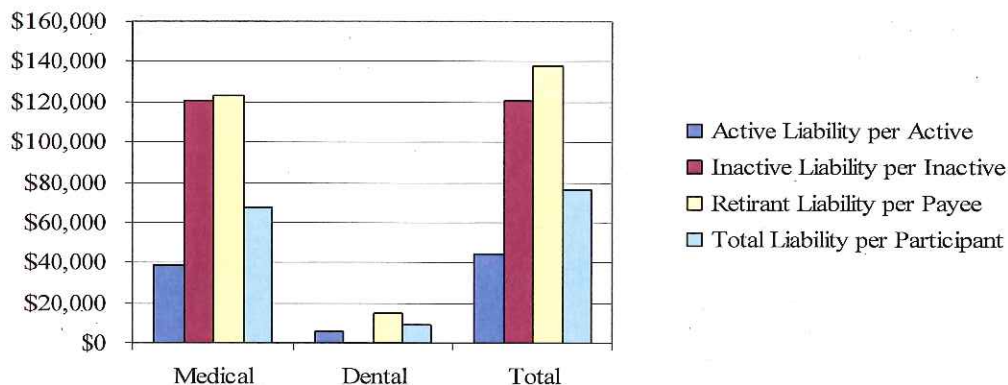
The following summarizes the results for the June 30, 2006 valuation using the projected unit credit funding method and assuming a long-term discount rate of 8.25%.

	<u>Medical</u>	<u>Dental</u>	<u>Total</u>
Total Normal Cost	\$10,174,634	\$1,757,327	\$11,931,961
Less: Employee Contributions			\$8,318,074
Employer Normal Cost			\$3,613,887
Actuarial Liability			
Actuarial Liability - Active Lives	\$148,212,294	\$21,080,082	\$169,292,376
Actuarial Liability - Inactive Lives	\$7,852,245	\$0	\$7,852,245
Actuarial Liability - Retired Lives	\$233,489,299	\$32,679,592	\$266,168,891
Total Actuarial Liability	\$389,553,838	\$53,759,674	\$443,313,512
Assumed Discount Rate	8.25%	8.25%	8.25%
Medical Trend	12% graded down to 4%	6% graded down to 4%	

**Per Participant Summary**

Total Normal Cost per Active	\$2,671	\$461	\$3,133
Employer Normal Cost per Active	\$809	\$140	\$949
Active Liability per Active	\$38,911	\$5,534	\$44,445
Inactive Liability per Eligible Inactive	\$120,804	\$0	\$120,804
Retirant Liability per Payee	\$123,474	\$14,721	\$138,195
Total Liability per Participant	\$67,572	\$8,917	\$76,489

**Actuarial Liability Per Participant**





City of San Jose  
**Summary of Valuation Results**  
*Scenarios with Alternate Actuarial Assumptions*  
June 30, 2006

We have calculated the Annual Required Contribution (ARC) as described in GAS 45 for Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions. Note that this amount is an accounting requirement, not a funding requirement. GAS 45 does not mandate pre-funding.

	6/30/2006 Original Valuation PUC	Alternate Scenarios			
		Higher Ultimate Trend PUC	Higher Ultimate Trend EAN	Lower discount Higher Ultimate Trend PUC	Lower discount Higher Ultimate Trend EAN
<b>Actuarial Liability</b>					
Actuarial Liability - Active Lives	\$169,292,376	\$177,531,652	\$210,513,077	\$295,586,681	\$332,052,460
Actuarial Liability - Inactive Lives	\$7,852,245	\$8,220,894	\$8,220,894	\$13,034,246	\$13,034,246
Actuarial Liability - Retired Lives	<u>\$266,168,891</u>	<u>\$270,998,373</u>	<u>\$270,998,373</u>	<u>\$357,851,959</u>	<u>\$357,851,959</u>
Total Actuarial Liability	\$443,313,512	\$456,750,919	\$489,732,344	\$666,472,886	\$702,938,665
<b>Funded Status</b>					
Actuarial Value of Assets	\$81,288,000	\$81,288,000	\$81,288,000	\$81,288,000	\$81,288,000
Actuarial Liability	<u>\$443,313,512</u>	<u>\$456,750,919</u>	<u>\$489,732,344</u>	<u>\$666,472,886</u>	<u>\$702,938,665</u>
Unfunded Actuarial Liability	\$362,025,512	\$375,462,919	\$408,444,344	\$585,184,886	\$621,650,665
Plan Funded Ratio	18%	18%	17%	12%	12%
<b>Required Expense and Net Obligation</b>					
Normal Cost	\$3,613,887	\$4,301,475	\$2,600,154	\$13,763,819	\$12,697,832
Amortization of Unfunded Actuarial Liability	<u>\$20,735,650</u>	<u>\$21,505,301</u>	<u>\$23,394,371</u>	<u>\$24,313,134</u>	<u>\$25,828,206</u>
Annual Required Contribution (ARC)	\$24,349,537	\$25,806,776	\$25,994,525	\$38,076,953	\$38,526,038
Annual OPEB Cost	\$24,349,537	\$25,806,776	\$25,994,525	\$38,076,953	\$38,526,038
Net OPEB Obligation	\$0	\$0	\$0	\$0	\$0
Amortization Period (years)	30	30	30	30	30
Assumed Discount Rate	8.25%	8.25%	8.25%	5.60%	5.60%
Payroll	\$275,558,882	\$275,558,882	\$275,558,882	\$275,558,882	\$275,558,882
ARC as percent of payroll	8.8%	9.4%	9.4%	13.8%	14.0%
Medical Trend	12% graded down to 4%	12% graded down to 4.5%	12% graded down to 4.5%	12% graded down to 4.5%	12% graded down to 4.5%
Dental Trend	6% graded down to 4%	6% graded down to 4%	6% graded down to 4%	6% graded down to 4%	6% graded down to 4%
<i>Change in ARC in relation to original valuation</i>		<i>\$1,457,239</i>	<i>\$1,644,988</i>	<i>\$13,727,416</i>	<i>\$14,176,501</i>

**City of San Jose**  
**Sensitivity Analysis In Original Valuation**

June 30, 2006

The calculation of the liabilities is sensitive to the assumption of medical inflation. To test the sensitivity we have calculated the Annual Required Contribution (ARC) using medical inflation rates 1% higher and 1% lower in each future year.

	<b>Original 6/30/2006 Valuation</b>	<b>Increase or Decrease in Medical Trend</b>	
		<b>+1%</b>	<b>-1%</b>
Normal Cost - Active Lives	\$3,613,887	\$6,302,539	\$1,512,224
Actuarial Liability - Active Lives	\$169,292,376	\$202,829,448	\$142,510,313
Actuarial Liability - Inactive Lives	\$7,852,245	\$9,245,945	\$6,715,575
Actuarial Liability - Retired Lives	<u>\$266,168,891</u>	<u>\$293,432,363</u>	<u>\$242,706,556</u>
Total Actuarial Liability	\$443,313,512	\$505,507,756	\$391,932,444
<b>Required Expense</b>			
Actuarial Value of Assets	\$81,288,000	\$81,288,000	\$81,288,000
Actuarial Liability	<u>\$443,313,512</u>	<u>\$505,507,756</u>	<u>\$391,932,444</u>
Unfunded Actuarial Liability	\$362,025,512	\$424,219,756	\$310,644,444
Normal Cost	\$3,613,887	\$6,302,539	\$1,512,224
Amortization of Unfunded Actuarial Liability	<u>\$20,735,650</u>	<u>\$24,297,935</u>	<u>\$17,792,709</u>
Annual Required Contribution (ARC)	\$24,349,537	\$30,600,474	\$19,304,933
Amortization Period (years)	30	30	30
Assumed Discount Rate	8.25%	8.25%	8.25%
Medical Trend	Base Trend Rates	Trend + 1%	Trend - 1%
Payroll	\$275,558,882	\$275,558,882	\$275,558,882
ARC as percent of payroll	8.8%	11.1%	7.0%

**City of San Jose**

**Projection of Future Annual Benefits In Original Valuation**

June 30, 2006

We have projected health benefits, net of retiree payments, to be paid by the Retirement System for the next 15 years. Our calculations are based on valuation assumptions and projected demographics of current and future retirees.

<u>Year</u>	<u>Medical</u>			<u>Dental</u>			<u>Grand</u>
	<u>Future Retirees</u>	<u>Current Retirees</u>	<u>Total</u>	<u>Future Retirees</u>	<u>Current Retirees</u>	<u>Total</u>	<u>Total</u>
1	\$371,361	\$14,858,134	\$15,229,495	\$79,757	\$2,461,044	\$2,540,801	\$17,770,296
2	1,220,807	16,064,622	17,285,429	246,291	2,558,046	2,804,337	20,089,766
3	2,209,783	17,166,029	19,375,812	424,051	2,647,805	3,071,856	22,447,668
4	3,437,484	18,161,963	21,599,447	626,978	2,729,537	3,356,515	24,955,962
5	4,892,190	19,006,495	23,898,685	857,263	2,801,815	3,659,078	27,557,763
6	6,528,029	19,666,656	26,194,685	1,102,858	2,864,023	3,966,881	30,161,566
7	8,160,489	20,115,149	28,275,638	1,350,465	2,914,979	4,265,444	32,541,082
8	9,880,510	20,307,974	30,188,484	1,605,217	2,954,322	4,559,539	34,748,023
9	11,688,364	20,298,569	31,986,933	1,877,806	2,981,182	4,858,988	36,845,921
10	13,757,113	20,206,693	33,963,806	2,175,483	2,995,473	5,170,956	39,134,762
11	16,003,388	20,082,782	36,086,170	2,482,475	3,004,024	5,486,499	41,572,669
12	18,180,980	19,934,094	38,115,074	2,783,587	3,006,733	5,790,320	43,905,394
13	20,444,766	19,754,716	40,199,482	3,097,888	3,003,495	6,101,383	46,300,865
14	22,979,793	19,531,595	42,511,388	3,441,615	2,994,198	6,435,813	48,947,201
15	25,634,402	19,271,517	44,905,919	3,797,734	2,978,703	6,776,437	51,682,356



**City of San Jose**  
**Participant Summary**

June 30, 2006

**Active Employees**

Age Group	<u>0-4</u>	<u>5-9</u>	<u>10-14</u>	<u>15-19</u>	<u>20+</u>	<u>Total</u>
0- 4	-	-	-	-	-	-
5- 9	-	-	-	-	-	-
10-14	-	-	-	-	-	-
15-19	-	-	-	-	-	-
20-24	19	3	-	-	-	22
25-29	108	101	2	-	-	211
30-34	119	215	40	7	-	381
35-39	120	204	81	72	11	488
40-44	79	210	80	159	76	604
45-49	65	160	78	191	189	683
50-54	69	144	74	147	236	670
55-59	42	114	58	109	139	462
60-64	13	65	34	50	51	213
65+	<u>5</u>	<u>18</u>	<u>17</u>	<u>14</u>	<u>21</u>	<u>75</u>
Total	639	1,234	464	749	723	3,809

Average Age:	45.5
Average Service:	11.7
Average Future Working Lifetime:	10.5
Aggregate Annual Payroll:	\$275,558,882

**Inactives Eligible for Medical Coverage upon Retirement**

Count	65
Average Age:	50.8

**Participating Retirees and Beneficiaries by Coverage**

	<u>Medical</u>	<u>Dental</u>
1 Person Coverage	879	
2+ Person Coverage	<u>1,012</u>	
Total	1,891	2,220
Average Age:	67.8	69.4

**City of San Jose**  
**Participant Summary**

June 30, 2006

**Census Distribution by Plan**

Medical premium rates for the City of San Jose are based on the combined experience of Federated and Police & Fire (P&F) members. Therefore, we used combined medical plan participant data, shown below, to develop age-adjusted medical premiums as described on page 19.

<u>Plan Name</u>	<u>Single<sup>1</sup></u>	<u>Dual/Family</u>	<u>Total</u>
<b><i>Medical</i></b>			
<b>Federated and P&amp;F Actives</b>			
Kaiser	873	2,403	3,276
BS HMO	277	1,011	1,288
BS POS	102	113	215
BS PPO	<u>106</u>	<u>169</u>	<u>275</u>
<b>Subtotal - actives</b>	<b>1,358</b>	<b>3,696</b>	<b>5,054</b>
<b>Federated and P&amp;F Pre 65 Retirees</b>			
Kaiser	419	608	1,027
BS HMO	91	168	259
BS POS	98	76	174
BS PPO	<u>241</u>	<u>216</u>	<u>457</u>
<b>Subtotal - pre 65 retirees</b>	<b>849</b>	<b>1,068</b>	<b>1,917</b>
<b>Federated and P&amp;F Post 65 Retirees</b>			
Kaiser SA	487	220	707
Secure Horizons	53	25	78
PacifiCare	24	7	31
BS - PPO	463	336	799
BS - HMO	<u>43</u>	<u>9</u>	<u>52</u>
<b>Subtotal - post 65 retirees</b>	<b>1,070</b>	<b>597</b>	<b>1,667</b>
<b><i>Dental</i></b>			
<b>Federated Retired Dental Participants<sup>2</sup></b>			
Delta Dental PPO			1,821
Delta Care PMI			51
<b>Total</b>			<b>1,872</b>

<sup>1</sup> Split plan participants are each treated as 2 single-coverage participants

<sup>2</sup> Dental coverage data for Surviving Spouses was not provided. We assumed 100% of the 348 current surviving spouses elected dental coverage.

**City of San Jose**  
**Participant Summary**

June 30, 2006

**Dependent Coverage**

The City of San Jose medical rates for non-Medicare members are developed for single coverage and family coverage. Because non-Medicare retirees with family coverage have a lower average number of dependents covered than actives with family coverage, we made an adjustment in our premium development. Using the blended family rates and values below, we derived a single coverage rate and then applied a family load for Federated non-Medicare retired members with family coverage which was relatively lower than that for the blended rate. Single coverage rates are shown on page 19. Second person coverage rates for current and future non-Medicare Federated retirees were loaded by 122%.

**Average Number of Dependents Covered per Health Covered Non-Medicare Family**

Federated Actives	1.62
Federated Retirees	1.22
P&F Actives	2.09
P&F Retirees	1.28



**City of San Jose**  
**Retiree Health Benefits**

June 30, 2006

**National Medical Care Consumer Price Index**  
**(Changes are December - December)**

<u>Year</u>	<u>Annual Change</u>	<u>5-Year Average</u>	<u>10-Year Average</u>
1965	2.82%	2.53%	3.21%
1966	6.67%	3.23%	3.54%
1967	6.25%	4.05%	3.70%
1968	6.23%	4.79%	3.87%
1969	6.19%	5.62%	4.11%
1970	7.36%	6.54%	4.52%
1971	4.57%	6.12%	4.66%
1972	3.28%	5.52%	4.78%
1973	5.29%	5.33%	5.06%
1974	12.56%	6.56%	6.09%
1975	9.82%	7.05%	6.79%
1976	9.96%	8.13%	7.12%
1977	8.87%	9.28%	7.38%
1978	8.83%	10.00%	7.64%
1979	10.14%	9.52%	8.03%
1980	9.92%	9.54%	8.29%
1981	12.50%	10.04%	9.08%
1982	11.00%	10.47%	9.87%
1983	6.40%	9.97%	9.99%
1984	6.11%	9.15%	9.34%
1985	6.76%	8.52%	9.03%
1986	7.71%	7.58%	8.80%
1987	5.80%	6.55%	8.49%
1988	6.91%	6.66%	8.30%
1989	8.50%	7.13%	8.14%
1990	9.59%	7.69%	8.11%
1991	7.92%	7.74%	7.66%
1992	6.63%	7.90%	7.23%
1993	5.39%	7.60%	7.13%
1994	4.92%	6.88%	7.00%
1995	3.95%	5.75%	6.72%
1996	3.04%	4.78%	6.25%
1997	2.82%	4.02%	5.94%
1998	3.42%	3.63%	5.59%
1999	3.67%	3.38%	5.11%
2000	4.17%	3.42%	4.58%
2001	4.72%	3.76%	4.27%
2002	5.05%	4.20%	4.11%
2003	3.71%	4.26%	3.94%
2004	4.24%	4.38%	3.88%

**City of San Jose**  
**Definitions of Technical Terms**

June 30, 2006

Actuarial Accrued Liability. The difference between the actuarial present value of system benefits and the actuarial value of future normal costs. Also referred to as "accrued liability" or "actuarial liability".

Actuarial Assumptions. Estimates of future experience with respect to rates of mortality, disability, turnover, retirement, rate or rates of investment income and salary increases. Actuarial assumptions (rates of mortality, disability, turnover and retirement) are generally based on past experience, often modified for projected changes in conditions. Economic assumptions (salary increases and investment income) consist of an underlying rate in an inflation-free environment plus a provision for a long-term average rate of inflation.

Accrued Service. Service credited under the system which was rendered before the date of the actuarial valuation.

Actuarial Equivalent. A single amount or series of amounts of equal actuarial value to another single amount or series of amounts, computed on the basis of appropriate actuarial assumptions.

Actuarial Cost Method. A mathematical budgeting procedure for allocating the dollar amount of the actuarial present value of retirement system benefits between future normal cost and actuarial accrued liability. Sometimes referred to as the "actuarial funding method".

Actuarial Gain (Loss). The difference between actual experience and actuarial assumption anticipated experience during the period between two actuarial valuation dates.

Actuarial Present Value. The amount of funds currently required to provide a payment or series of payments in the future. It is determined by discounting future payments at predetermined rates of interest, and by probabilities of payment.

Amortization. Paying off an interest-discounted amount with periodic payments of interest and principal -- as opposed to paying off with lump sum payment.

Annual Required Contribution (ARC). As described in the GASB Statement 45, is the sum of the employer's current normal cost, the amortized unfunded actuarial liability and an interest adjustment (if applicable).

**City of San Jose**  
**Definitions of Technical Terms**

June 30, 2006

Net OPEB Obligation (NOO). As described in the GASB Statement 45, is the ARC adjusted for historical differences between the ARC and actual contributions made. In the first year the employer adopts the new statements, the NOO is equal to zero. Also, if the employer contributes the ARC each year, the NOO will always equal zero.

Annual OPEB Cost (AOC). As described in the GASB Statement 45 *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, is the ARC adjusted for interest and amortization of the NOO. In the first year the employer adopts the new statements, the AOC is equal to the ARC. Also, if the employer contributes the ARC each year, the AOC will always equal the ARC.

Normal Cost. The actuarial present value of retirement system benefits allocated to the current year by the actuarial cost method.

Unfunded Actuarial Accrued Liability. The difference between actuarial accrued liability and valuation assets. Sometimes referred to as "unfunded actuarial liability" or "unfunded accrued liability".

Most retirement systems have unfunded actuarial accrued liability. They arise each time new benefits are added and each time an actuarial loss is realized.

The existence of unfunded actuarial accrued liability is not in itself bad, any more than a mortgage on a house is bad. Unfunded actuarial accrued liability does not represent a debt that is payable today. What is important is the ability to amortize the unfunded actuarial accrued liability and the trend in its amount (after due allowance for devaluation of the dollar). It is best practice that unfunded actuarial accrued liability be controlled.