

GRS Gabriel Roeder Smith & Company Consultants & Actuaries

FEDERATED CITY EMPLOYEES' RETIREMENT SYSTEM **ACTUARIAL VALUATION REPORT** AS OF JUNE 30, 2007



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January 2, 2008

Board of Administration Federated City Employees' Retirement System 1737 N First Street Suite 580 San Jose, CA 95112-4505

#### Re: Federated City Employees' Retirement System Actuarial Valuation as of June 20, 2007

Dear Members of the Board:

We are pleased to present the report of the actuarial valuation of the Federated City Employees' Retirement System of the City of San Jose ("System") as of June 30, 2007.

This valuation provides information on the funding status of the System. In addition, it includes a determination of the actuarially calculated contribution levels for the 2009 fiscal year (beginning July 1, 2008) and the 2010 fiscal year.

This valuation is based on the provisions of the System in effect as of the valuation date, data on the System membership and information on the asset value of the trust fund as of that date. All member data and asset information were provided by System staff. While certain checks for reasonableness were performed, the data used was unaudited.

The actuarial assumptions and cost method are identical to those used in the prior actuarial valuation of the System.

To the best of our knowledge, this actuarial statement is complete and accurate, and has been prepared in accordance with generally accepted actuarial principles and practice.

Respectfully submitted,

Gabriel, Roeder, Smith & Co.

desuid Thompson

Leslie Thompson, EA, FSA, MAAA Senior Consultant

## Table of Contents

		Page
Section A	Report Highlights	2
Section B	Comments & Recommendations on Actuarial Valuation	4
Section C	Financial Principles and Operational Techniques	7
Section D	Valuation Results	12
Section E	Funding Progress/ Disclosures Required by Statements 25 & 27 of GASB	20
Section F	Summary of Benefit Provisions	24
Section G	Asset Information Table 1 - Net Assets Available for Benefits Table 2 - Change in Assets Available for Benefits Table 3 - Development of Actuarial Value of Assets	29
Section H	Membership Data Table 4 - Summary of Data Characteristics Table 5 - Distribution of Active Members and Payroll	33
Section I	Actuarial Method and Assumptions	36
Section J	Definitions of Technical Terms	45

# **SECTION A**

## **REPORT HIGHLIGHTS**

# Report Highlights

The following is a set of key results for the prior valuation and for the current year:

	June 30, 2005	June 30, 2007	Percent
I. Total Membership			
A. Active Members	4,148	3,942	(4.97)%
B. Pensioners	2,426	2,691	10.92%
C. Inactive	438	673	53.65%
II. Valuation Compensation as of June 30			
A. Total Annual Payroll	\$286,445,861	<b>\$291,404,606</b>	<mark>1.73%</mark>
<b>B.</b> Average Annual Compensation	\$69,056	\$73,923	<mark>7.05%</mark>
III. Benefits to Current Pensioners and Beneficiaries			
A. Total Annual Benefits	\$69,465,541	\$84,723,411	21.96%
B. Average Annual Benefit	\$28,634	\$31,484	9.95%
IV. Total System Assets		-	
A. Actuarial Value (net of excludables)	\$1,461,444,000	\$1,711,602,000	17.12%
1. Retirement Assets	1,384,454,000	1,622,851,000	17.22%
2. Health Assets	76,990,000	88,751,000	15.28%
B. Market Value	\$1,512,163,000	\$1,862,998,000	23.20%
V. Unfunded Actuarial Accrued Liability/(Surplus)			
A. Retirement Benefits	\$326,915,830	\$338,091,729	3.42%
B. Health and Dental Benefits	\$235,659,694	\$332,328,444	41.02%
VI. Budget Items			
A. Employer Cost (% of Pay)			
1. Retirement Benefits	18.16%	18.31%	0.15%
2. Health & Dental Benefits	3.82%	5.25%	1.43%
3. Total	21.98%	23.56%	1.58%
B. Employee Cost (% of pay)			
1. Retirement Benefits	4.26%	4.28%	0.02%
2. Health & Dental Benefits	3.32%	4.65%	1.33%
3. Total	7.58%	8.93%	1.35%
C. Total Contribution Rate (% of pay)	29.56%	32.49%	2.93%
VII. Funded Ratio			
(Based on Actuarial Value of Assets)			
A. Retirement Benefits	80.9%	82.8%	1.90%
B. Health Subsidy Benefits	24.6%	21.1%	(3.50)%
C. Total	72.2%	71.9%	(0.30)%
(Based on Market Value of Assets)			
D. Total	74.7%	78.2%	3.50%

# SECTION B

COMMENTS AND RECOMMENDATIONS

### Comments & Recommendations

**<u>COMMENT A:</u>** The contribution rate for the System increased from 29.56% to 32.49%. Based on the provisions of the Ordinance this total rate is allocated as follows:

- 1) 23.56% to the City
- 2) 8.93% to the employees

**<u>COMMENT B</u>**: The retirement benefit funded ratio increased from 80.9% to 82.8%. The health benefit funded ratio decreased from 24.6% to 21.1%. The overall funded ratio dropped from 72.2% to 71.9%.

**<u>COMMENT C</u>**: The principal reasons for the changes in contribution rates are as follows. Please refer to page 16 for additional details:

- There was a \$47.7 million gain on the actuarial value of assets. For this purpose, gains and losses are calculated relative to the 8.25% investment assumption. Deferred gains total \$132,806,000 and will enter the actuarial value of assets according to the 5 year smoothing schedule. As shown on Table 3 in Section G, each year has a gain that is being smoothed into the actuarial value of assets.
- 2) Retiree medical premiums increases and more retirees receiving medical benefits than expected.
- 3) The total net increase in the contribution rate is 2.93%. 2.76% of that increase is due to two explicit factors in the health subsidy plan- the premium increases and then all other factors and assumptions that lead to an increase in the accrued liability (e.g. contribution less than the actuarially required).
- 4) There was a slight salary and mortality loss. (Salaries increases slightly more than expected, and there were slightly fewer deaths than expected).

**<u>COMMENT D</u>**: Due to actuarial smoothing, the market value of assets is not directly used in calculating computed rates. Unexpected market fluctuations are spread over a 5-year time frame. There is now a total deferred gain of \$132,806,000 that will come into the actuarial value of assets according to the 5 year smoothing schedule.

### Comments & Recommendations

Using market value, the overall funded ratio is 78.2% compared to 71.9% using the actuarial value of assets. The funded ratio for health subsidy benefits decreased from 24.6% to 21.1%, while the funded ratio for pension increased from 80.9% to 82.8%. This illustrates how the health subsidy liabilities are growing faster than their assets.

**<u>COMMENT E:</u>** The Unfunded Accrued Liability (UAL) increased 3.42% on the retirement plan, and 41.02% on the health subsidy plan. This growth on the health subsidy plan indicates a need to further examine the liabilities of the plan in relation to the contributions. If the UAL continues to have large increases that are not offset by assets in trust, and if the actuarially required contribution are not made, then the health subsidy plan will require either an increase in assets or a reduction in liabilities to bring it back into actuarial balance (and to maintain long term solvency).

**<u>COMMENT F</u>**: The SRBR reserve balance as of June 30, 2007 was \$18,590,000 as reported to us by Staff. This is excluded from valuation assets.

**<u>COMMENT G</u>**: There were two interesting demographic developments. The number of active employees decreased by (5.0%) and the average age of an active member increased from 45.0 to 45.5 years. Part of the decrease is due to now treating leave of absence members as terminated members instead of actives. The prior valuation at 2005 also showed a decrease in the active population.

**<u>COMMENT H:</u>** We recommended no change to the actuarial assumptions for the retirement valuation. The total contribution change due to the non-health subsidy experience was 0.17% - a strong indicator that assumptions are matching retirement experience very closely. The Health Subsidy plan experience will be more fully reviewed with the valuation under GASB 45.

**<u>COMMENT I:</u>** The Health Subsidy Plan contribution rate increased significantly from 7.14% to 9.90%. This is due to the adverse experience, such as premiums being higher than anticipated and contributions less than the actuarially required contribution. This report illustrates a "Policy" contribution, which is a contribution that is determined based on a policy set by the Board. The actuarially required contribution is set forth in a separate valuation that has been prepared in accordance with GASB 45.

# **SECTION C** FINANCIAL PRINCIPLES AND OPERATIONAL TECHNIQUES

### Financial Principles and Operational Techniques

<u>Promises Made, and To Be Paid For</u>. As each year is completed, the Retirement System in effect hands an "IOU" to each member then acquiring a year of service credit – the "IOU" says: "The San Jose Federated City Employees' Retirement System owes you one year's worth of retirement benefits, payments in cash commencing when you qualify for retirement."

The related key financial questions are:

#### Which generation of taxpayers contributes the money to cover the IOU?

The present taxpayers, who receive the benefit of the member's present year of service; or

The future taxpayers, who happen to be in San Jose at the time the

IOU becomes a cash demand, years and decades later?

The principle of level percent of payroll financing intends that this year's taxpayers contribute the money to cover the IOUs being handed out this year. By following this principle, the employer contribution rate will remain approximately level from generation to generation (after funding of the system's initial unfunded liability is addressed) – our children and our grandchildren will contribute the same percents of active payroll we contribute now.

(There are systems which have a design for deferring contributions to future taxpayers, lured by a lower contribution rate now and putting aside the consequence that the contribution rate must then grow much greater over decades of time.)

An inevitable by-product of the level-cost design is the accumulation of reserve assets, for decades, and income produced when the assets are invested. Invested assets are a by-product and not the objective. Investment income becomes, in effect, the  $3^{rd}$  contributor for benefits to employees, and is interlocked with the contribution amounts required from employees and employer.

## Financial Principles and Operational Techniques

Translated to actuarial terminology, this level-cost objective means that the contribution rates must total at least the following:

Current Cost (the cost of members' service being rendered this year) . . .

plus. . .

Interest on Unfunded Accrued Liability (UAL is the difference between (i) liabilities for service already rendered and (ii) the assets of the plan).

<u>Computing Contributions to Support System Benefits</u>. From a given schedule of benefits and from the employee data and asset data furnished, the actuary determines the contribution rates to support the benefits, by means of <u>an actuarial valuation and a funding method</u>.

An actuarial valuation has a number of ingredients such as: the rate of investment return which plan assets will earn; rates of withdrawal of active members who leave covered employment; rates of mortality; rates of disability; rates of pay increases; and the assumed age or ages at actual retirement. In an actuarial valuation, assumptions must be made as to what the above rates will be, for the next year and for decades in the future. Only the subsequent actual experience of the plan can indicate the degree of accuracy of the assumptions.

<u>Reconciling Differences Between Assumed Experience and Actual Experience</u>. Once actual experience has occurred and been observed, it will not coincide exactly with assumed experience, regardless of the wisdom behind the various financial assumptions or the skill of the actuary and the millions of calculations made. The future can be predicted with considerable but not complete precision, except for <u>inflation which defies reliable prediction</u>.

The System copes with these continually changing differences by having actuarial valuations. Each actuarial valuation is a complete recalculation of assumed future experience, taking into account all past differences between assumed and actual experience. The result is continual adjustments in the computed contribution rates.

## Financial Principles and Operational Techniques

#### THE ACTUARIAL VALUATION PROCESS

<u>The financing diagram</u> on the following page shows the relationship between the two fundamentally different philosophies of paying for retirement benefits: the method where contributions match cash benefit payments (or barely exceed cash benefit payments, as in the Federal Social Security program) which is an <u>increasing contribution method</u>; and the <u>level</u> <u>contribution method</u> which equalizes contributions between the generations.

The actuarial valuation is the mathematical process by which the level contribution rate is determined. The flow of activity constituting the valuation may be summarized as follows:

A. Covered people data, furnished by staff, including:

Retired members now receiving benefits

Former employees with vested benefits not yet payable

Active employees

- B. + Asset data (cash & investments), furnished by staff
- C. + <u>Assumptions concerning future experience in various risk areas</u>, which are established by the Board after consulting with the actuary
- D. + <u>The funding method</u> for employer contributions (the long-term, planned pattern for employer contributions)
- E. + Mathematically combining the assumptions, the funding method, and the data
- F. = <u>Determination of:</u> Plan Financial Position and/or Employer's New Contribution Rate



CASH BENEFITS LINE. This relentlessly increasing line is the fundamental reality of relirement plan financing. It happens each time a new benefit is added for future retirements (and happens regardless of the design for contributing for benefits).

LEVEL CONTRIBUTION LINE. Determining the level contribution line requires detailed assumptions concerning a variety of experiences in future decades, including:

**Economic Risk Areas** 

- Rates of investment return
- Rates of pay increase
- Changes in active member group size
- Non-Economic Risk Areas
  - Ages at actual retirement
  - Rates of mortality
  - Rates of withdrawal of active members (turnover)
  - Rates of disability

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# **SECTION D** VALUATION RESULTS

## Valuation Results Total Actuarial Contribution

The San Jose Municipal Code provides that the required annual contribution is allocated between the City and the members as follows:

- The Current Service Rate (Normal Rate) is the cost for funding liabilities for service after July 1, 1975. This cost is shared 8/3 between the City and the Members.
- The **Current Service Deficiency Rate** is the amortization of the funding deficiency for service after July 1, 1975 which is not covered by the Current Service Rate. The City bears this entire cost.
- The **Prior Service Rate** is the difference in costs between the current plan and the predecessor plan (the "1964 Plan") for service before July 1, 1975. The cost is shared 58/42 between the City and the Members. Additionally, the City's Prior Service Rate reflects the entire cost for any gains or losses associated with liabilities for service prior to July 1, 1975 (**Prior Service Deficiency Rate**).
- The Golden Handshake Rate is the cost for funding the additional benefits granted to certain retiring employees. The City bears this entire cost.
- The **Reciprocity Rate** represents prefunding of the liability associated with the adoption of reciprocal benefits with other public pension plans. The City bears this entire cost.

Under the Municipal Code, the contribution is allocated between the City and the members as follows:

- The Health Insurance Rate is the cost for funding, as a level percent of payroll, a 15year projection of premiums. The cost is shared 50/50 between the City and the Members.
- The Dental Insurance Rate is the cost for funding, as a level percent of payroll, a 15year projection of premiums. The cost is shared 8/3 between the City and the Members.

The contribution rates developed in this valuation are summarized as follows:

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# Valuation Results Explanation of Contribution Change Since the Last Valuation

The effect of experience on the System's total contribution rate is as follows:

June 30, 2005 Pension and Medical Contribution Rate		29.56%
Decrease due to Investment Gains	(0.99)%	
Decrease due to lesser number of retirements than anticipated	(0.14)%	
Increase due to Salary Losses	0.11%	
Decrease Due to Open Amortization Period	(0.23)%	
Increase due to Retiree Medical Premium increases	1.03%	
Increase in retiree medical rate due to funding method	1.73%	
Increase due to contribution timing lag	0.58%	
Increase due to post-retirement mortality loss	0.07%	
Other miscellaneous factors	<u>0.77%</u>	
Total Change in Contribution Rate		2.93%
June 30, 2007 Pension and Medical Total Contribution Rate		32.49%

Computed	Contribution	Rates - Historic	Comparison
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Valuation		CITY		MEMBER	TOTAL	Valuation
Date	<u>Retirement</u>	<u>Health</u>	<u>Total</u>	-		<u>Payroll</u>
						(thousands)
6/30/1991	n/a	n/a	n/a	n/a	22.47%	n/a
6/30/1993	n/a	n/a	n/a	n/a	26.13%	\$145,781
6/30/1995	n/a	n/a	n/a	n/a	26.65%	153,918
6/30/1997	n/a	n/a	n/a	n/a	21.83%	176,284
6/30/1999	15.33%	0.76%	16.09%	4.76%	20.85%	193,650
6/30/2001	13.82%	1.38%	15.20%	5.08%	20.28%	252,696
6/30/2003	14.96%	2.16%	17.12%	6.06%	23.18%	292,961
6/30/2005	18.16%	3.82%	21.98%	7.58%	29.56%	286,446
6/30/2007	18.31%	5.25%	23.56%	8.93%	32.49%	291,405

#### Recommended Contributions for Retirement Benefits Fiscal Years 2009 and 2010

	City	Members
For Basic Retirement Benefits		
Current Service Normal Rate	8.79%	3.29%
Current Service Deficiency Rate	3.44%	N/A
Prior Service Normal Rate	0.01%	0.01%
Prior Service Deficiency Rate	1.14%	N/A
Retirement Golden Handshake Rate	0.28%	N/A
Reciprocity	0.45%	N/A
Total Contributions for Basic Retirement Benefits	14.11%	3.30%
For Cost-of-Living (COL) Retirement Benefits		
Current Service Normal Rate	2.60%	0.98%
Current Service Deficiency Rate	1.37%	N/A
Prior Service Normal Rate	0.01%	0.00%
Prior Service Deficiency Rate	0.00%	N/A
Retirement Golden Handshake Rate	0.08%	N/A
Reciprocity	0.14%	N/A
Total Contributions for COL Retirement Benefits	4.20%	0.98%

Total Contributions for Retirement Benefits	18.31%	4.28%
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- 14

### **Summary of Actuarial Values**

### (\$ in 000's)

		Entry Age Act	uarial Values
		Actuarial	
	Present Value	Accrued	
	of Projected	Liability	Normal Cost
	Benefits	(AAL)	% of Pay
(1) Active Members			
a. Retirement	\$ 1,054,985	\$ 800,149	11.98%
b. Termination	66,061	29,668	1.56%
b. Death	22,713	12,871	0.46%
c. Disability	61,100	32,691	1.35%
d. Refunds	23,173	9,762	0.59%
Total	\$ 1,228,032	\$ 885,141	15.94%
(2) Benefit Recipients	\$ 1,003,001	\$ 1,003,001	0.00%
(3) Other Inactives	72,801	72,801	0.00%
(4) Total Actuarial Values			
of Benefits	\$ 2,303,834	\$ 1,960,943	15.94%
(5) Actuarial Value of Assets		\$ 1,622,851	
(6) Unfunded Actuarial			
Accrued Liability: (4 - 5)		\$ 338,092	
(7) Funding Ratio		82.76%	

### Valuation Results Actuarial Balance Sheet - Retirement Benefits As of June 30, 2007 (\$ in 000's)

#### PRESENT VALUE AND EXPECTED FUTURE RESOURCES

				<u>Total</u>
(1)	Actuarial Value of Assets			\$ 1,622,851
(2)	, Present Value of Future City Contributions			
	a. Normal Rate		254,465	
	b. Deficiency Rate	319,594		
	c. Golden Handshake	18,498		
	d. Unfunded Accrued Liability: (b) + (c)		338,092	
	e. Total	-		592,557
(3)	Present Value of Future Member Contribution	ns		88,426
(4)	Total Present and Expected Future Resour	rces		\$ 2,303,834
P	RESENT VALUE OF EXPECTED FUTUE	<u>RE BENEFI</u> T	PAYMENTS A	AND RESERVE
				Total
(1)	To Retirees and Beneficiaries			\$ 1,003,001
(2)	To Vested Terminated and Inactive Members	1		72,801
(3)	To Active Members			
	a. Allocated to service rendered prior			
	to valuation date		885,141	
	b. Allocated to service expected to be			
	rendered in the future		342,891	
	c. Total			1,228,032
(4)	Total Present Value of Expected Future Be	enefit Payme	nts	\$ 2,303,834

- 16

### Actuarial Balance Sheet - Health Subsidy Benefits As of June 30, 2007

### (\$ in 000's)

Assets		
(1) Current Assets Available for Benefits		\$ 88,751
(2) Present Value of Future Contributions		
a. City	176,235	
b. Members	156,093	
c. Total		332,328
(3) Total Assets		421,079
Liabilities		

(4) Present Value of Subsidies for the Next 15 Years \$421
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#### Policy Contributions for Health Subsidy Benefits Fiscal Years 2009 and 2010

	City	Members
Medical Insurance Rate	4.28%	4.28%
Dental Insurance Rate	0.97%	0.37%
Total	5.25%	4.65%

- 17

### Actuarial Balance Sheet - Health Subsidy Benefits As of June 30, 2007

#### (\$ in 000's)

· · · · A	ssets		
(1) Current Assets Available for Benefits		\$ 88,751	
(2) Present Value of Future Contributions	3		
a. City	176,235		
b. Members	156,093		
c. Total		332,328	
(3) Total Assets		421,079	
Lia	bilities .		

### (4) Present Value of Subsidies for the Next 15 Years \$421,079

#### Policy Contributions for Health Subsidy Benefits Fiscal Years 2009 and 2010

	City	Members
Medical Insurance Rate	4.28%	4.28%
Dental Insurance Rate	0.97%	0.37%
Total	5.25%	4.65%

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#### June 30, 2007

#### Derivation of Experience Gain (Loss)

Analysis of actuarial gains and losses in a pension benefit program is a review of the effects on actuarial results of actual experience that differs from assumed experience. If such a difference increases assets or reduces liabilities, there is an actuarial gain. The reverse is an actuarial loss.

(1) Unfunded Actuarial Accrued Liability (UAAL) as of June	e 30, 2005	\$326,915,830
<ul> <li>(2) Expected Change in UAAL during 2006 - 2007</li> <li>a. Normal Cost for 2006 - 2007</li> <li>b. Contributions during 2006 - 2007</li> <li>c. Interest adjustments on 1, 2a, &amp; 2b @ 8.25%</li> <li>d. Adjustment for timing lag of contributions</li> <li>e. Expected change in UAAL</li> </ul>	\$91,762,654 (117,036,000) 54,081,132 10,928,453	39,736,239
(3) Increase in UAAL due to Assumption Changes		0
(4) Expected UAAL as of June 30, 2007 [(1) + (2) + (3)]		366,652,069
(5) Actual UAAL as of June 30, 2007		338,091,729
<ul><li>(6) Total Gain / (Loss)</li><li>As a % of Accrued Liabilities at 6/30/2005</li></ul>		28,560,340 1.7%
Note:		
Asset Gain (Loss)		47,659,000
- As a % of Accrued Liabilities at 6/30/2005		2.8%
Liability Gain (Loss)		(19,098,660)
- As a % of Accrued Liabilities at 6/30/2005		(1.1)%

## **SECTION E** FUNDING PROGRESS-INFORMATION FOR GASB NO. 25 & 27

## Funding Progress Indicators June 30, 2007

There is no single all-encompassing indicator which measures a retirement system's funding progress and current funded status. A traditional measure has been the relationship of valuation assets to unfunded actuarial accrued liability -- a measure that is influenced by the choice of actuarial cost method.

We believe a better understanding of funding progress and status can be achieved using the following indicators which are independent of the actuarial cost method.

(1) The ratio of assets to the actuarial present value of credited projected benefits allocated in the proportion accrued service is to projected total service -- a plan continuation indicator. The ratio is expected to increase in the absence of benefit improvements or strengthening of actuarial assumptions.

(2) The ratio of the unfunded actuarial present value of credited projected benefits to member payroll - a plan continuation indicator. In a soundly financed retirement system, the amount of the unfunded actuarial present value of credited projected benefits will be controlled and prevented from increasing in the absence of benefit improvements or strengthening of actuarial assumptions. However, in an inflationary environment, it is seldom practical to impose this control on dollar amounts which are depreciating in value. The ratio is a relative index of condition where inflation is present in both items. The ratio is expected to decrease in the absence of benefit improvements or strengthening of actuarial assumptions.

# **Funding Progress**

### Schedule of Funding Status for Retirement Benefits (\$ in 000's)

	Actuarial					
End	Value of			Funding		UAAL as
of	Assets	AAL	UAAL	Ratio	Payroll	% of Payroll
Year	<u>(a)</u>	<u>(b)</u>	<u>(b-a)</u>	<u>(a/b)</u>	(c)	<u>((b-a)/c)</u>
1993	\$ 489,865	\$ 583,119	\$ 93,254	84.0%	\$ 145,781	64.0%
1995	566,102	658,175	92,073	86.0%	153,918	59.8%
1997	678,954	735,772	56,818	92.3%	176,284	32.2%
1999	804,860	862,226	57,366	93.4%	193,650	29.6%
2001	1,060,144	1,072,333	12,189	98.9%	252,696	4.8%
2003	1,280,719	1,311,691	30,972	97.6%	292,961	10.6%
2005	1,384,454	1,711,370	326,916	80.9%	286,446	114.1%
2007	1,622,851	1,960,943	338,092	82.8%	291,405	116.0%

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# **Funding Progress**

## Schedule of Employer Contributions

**Retirement Benefits Only** 

Fiscal		
Year	Annual Required Contribution	Percentage Contributed
1999/2000	15.37%	100.00%
2000/2001	15.33%	100.00%
2001/2002	15.33%	100.00%
2002/2003	13.82%	100.00%
2003/2004	13.82%	100.00%
2004/2005	14.96%	100.00%
2005/2006	14.96%	100.00%
2006/2007	18.16%	100.00%
2007/2008	18.16%	N/A

# **SECTION F** SUMMARY OF BENEFIT PROVISIONS

# Summary of Retirement Benefit Provisions

1.	Eligibility:		Members are eligible on their first day of City employment.
2.	Final Compensation:		Highest 12-month average salary, if separation takes place on or after July 1, 2001.
			Highest 36-month average salary, if separation takes place before July 1, 2001.
3.	Service Retirement:		
	A)	Eligibility:	Age 55 with 5 years of service, or any age with 30 years of service.
	B)	Benefit:	2.5% of Final Compensation for each year of service. Maximum benefit is 75% of Final Compensation.
	C)	Form of Payment:	Monthly benefit payable for the life of the member.
4.	Disal	oility Retirement:	·
	A)	Eligibility:	Physically or mentally incapacitated so unable to perform duties of position. If disability is not service connected, then the member must have at least five years of City service.
	B)	Benefit:	2.5% of Final Compensation per year of service. The maximum benefit is 75% and the minimum benefit is 40% of Final Compensation. Any Workers' Compensation benefits are offset from the benefits under this system.
			If the disability was non-service connected, then the benefit is reduced by .5% for every year under age 55.
			For those members who are hired on or after September 1, 1998, the non-service connected benefit is as follows:
			20% of Final Compensation for 6 years of service; Plus 2% for each years of service in excess of 6, but less than 16; Plus 2.5% for each year of service in excess of 16.
	C)	Form of Payment:	Monthly benefit payable for the life of the member.

- 24

### Summary of Retirement Benefit Provisions

#### 5. Deferred Service Retirement:

A)	Eligibility:	Five years of membership prior to termination of City service. Member must leave contributions on deposit until retirement.
B)	Benefit:	Same as Service Retirement, payable anytime after age 55.
C)	Form of Payment:	Same as Service Retirement.

#### 6. Pre-Retirement Death Benefits:

A)	Non-Service Connected with less than five years of service, or No Family		
	Members Eligible for Allowance:	Member's beneficiary or estate receives (i),	
	and (ii	) where:	

(i) = Accumulated contributions with interest.

(ii) = Lump sum benefit of one month's salary for each year of service, up to six years.

#### B) Service-Connected, or Non-Service Connected with five years of service:

Member's eligible survivor receives 2.5% of Final Compensation per years of service. The maximum benefit is 75% and the minimum benefit, if still an active employee at time of death, is 40% of Final Compensation, payable until the spouse remarries. If the Member was age 55 with 20 years of service at death, the benefit is payable for the lifetime of the Member's spouse.

7. Post-Retirement Death where: Benefits:

Member's eligible survivor receives (i) and (ii),

(i) = 50% continuance to surviving eligible spouse; if there is no surviving spouse, certain benefits are paid to the children.

(ii) = \$500 death benefit allowance for burial expenses at death of retired member.

### Summary of Retirement Benefit Provisions

#### 8. Post-retirement Cost-of-Living Benefits:

Each April 1, the benefits are increased by the percentage increase in CPI (to a maximum of 3%). Increases in CPI above 3% are "banked" to apply in years when CPI increase is less than 3%.

The first cost-of-living adjustment is on the first day of the month following the one-year anniversary of retirement. The next adjustment will be prorated for the number of months remaining until the following April.

9. Employee Contributions: The Members' contribution rates are recalculated on an actuarial basis at each actuarial study. Contributions are credited with 3% interest annually (the interest crediting provision was changed from 7.25% to 3% effective July 1, 2001).

All references to spouse also encompass registered domestic partners.

## **Summary of Health Subsidy Benefit Provisions**

1.	Eligibility:			
	A)	Medical	Fifteen years of service credit at retirement, or receiving an allowance of at least 37 1/2% of Final Compensation. Must be enrolled in a City medical insurance plan at retirement.	
	B)	Dental	Five years of service credit at retirement, or receiving an allowance of at least 37 1/2% of Final Compensation. Must be enrolled in a City dental insurance plan at retirement.	
2.	Benefit:			
	A)	Medical	The Retirement System pays 100% of the premium for the lowest cost medical plan offered by the City for single and family coverage. Members and eligible survivors pay for the difference in the premium for their selected plan and the portion paid by the Retirement System for the lowest cost plan.	
	B)	Dental	The Retirement System pays the entire cost of dental insurance coverage.	
3,	Contr	ributions:	Both the City and the Members contribute to the Retirement System fund for medical and dental insurance benefits.	

**NOTE:** Please inform the actuary **IMMEDIATELY** if any of the retirement or health benefit provision summaries are incorrect.

# **SECTION G** ASSET INFORMATION

## Asset Information

### Statement of Plan Net Assets June 30, 2007 (\$ in 000's)

		Post-Employement	
	Pension Benefits	Healthcare	Total
ASSETS			
Receivables			
Employee Contribution	466	364	830
Employer Contribution	2,034	428	2,462
Brokers and Others	89,030	4,908	93,938
Accrued Investment Income	6,389_	354	6,743
· · · · · · · · · · · · · · · · · · ·	97,919	6,054	103,973
Investments			
Short Term Funds	75,641	4,110	79,751
Short Term Currency Investments	(39)	(2)	(41)
Government Debt Securities	336,973	18,312	355,285
Corporate Debt Securities	236,312	12,842	249,154
Equities	1,099,525	59,751	1,159,276
Real Estate	77,140	4,192	81,332
Securities Lending Pool	183,786	10,132	193,918
	2,009,338	109,337	2,118,675
Total Assets	\$2,107,257	\$115,391	\$2,222,648
Liabilities			
Payable to Brokers	155,529	8,574	164,103
Securities Lending Collateral Due	183,786	10,132	193,918
Other Liabilities	1,545	84	1,629
Total Liabilities	\$340,860	\$18,790	\$359,650
Net Assets Available For Benefits	\$1,766,397	\$96,601	\$1,862,998

- 29

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## Asset Information

## Statement of Changes in Plan Net Assets For the Fiscal Year Ended June 30, 2007

(\$ in 000's)

		Post-Employement	
	Pension Benefits	Healthcare	Total
ADDITIONS			
Contributions			
Employee Contribution	12,370	9,612	21,982
Employer Contribution	51,004	10,728	61,732
	63,374	20,340	83,714
Investment Income			
Net Appreciation	207,706	11,349	219,055
Dividends and Interest	38,633	2,109	40,742
Net Rental Income	3,880	212	4,092
Investment Expense	(6,489)	(353)	(6,842)
Net Securities Lending Income	480	26	506
	244,210	13,343	257,553
Total Additions	307,584	33,683	341,267
DEDUCTIONS			
Retirement Benefits	75,135	-	75,135
Health Insurance Premiums	-	18,265	18,265
Death Benefits	5,867	-	5,867
Refunds	1,008	-	1,008
Administrative Expenses	1,845	105	1,950
Total Deductions	83,855	18,370	102,225
NET ASSETS AVAILABLE FOR E	BENEFITS		
Beginning of Year	1,542,668	81,288	1,623,956
End of Year	1,766,397	96,601	1,862,998

• 30

## Asset Information

### Development of Actuarial Value of Assets As of June 30, 2007 (\$ in 000's)

(1)	Market Value of Assets		1,862,998
(2)	Deferred Gains / (Losses)	Total	Deferred
	June 30, 2007 Gain (80% deferred)	124,325	99,460
	June 30, 2006 Gain (60% deferred)	16,539	9,924
	June 30, 2005 Gain (40% deferred)	6,778	2,711
	June 30, 2004 Gain (20% deferred)	103,558	20,711
	Total		132,806
(3)	Actuarial Value of Assets @ 6-30-2007 (1) -	(2)	1,730,192
	(including excludable assets)		
(4)	Allocation of Actuarial Value of Assets ("A	VA")	
	a. Post-employment Health Care Fund		88,751
	b. Retirement Benefits		
	Remaining AVA	1,641,441	
	Contingency Reserve	-	
	SRBR Reserve	18,590	
	<b>AVA for Retirement Benefits</b>		1,622,851
(5)	Final Actuarial Value of Assets for System	1	1,711,602

- 31

SECTION H MEMBERSHIP DATA
# Membership Data Summary of Data Characteristics

#### **Summary of Data Characteristics**

	June 30, 2005	June 30, 2007	Percentage Change
Active Members*			
Number	4,148	3,942	(5.0)%
Average Age	45.0	45.5	1.1%
Average Years of Service	11.4	11.6	1.8%
Total Annual Compensation	286,445,861	291,404,606	1.7%
Average Annual Compensation	69,056	73,923	7.0%
Retirees & Disabled Members			
Number	2,078	2,313	11.3%
Average Age	68.1	68.1	0.0%
Total Annual Allowance	63,998,727	78,613,023	22.8%
Average Annual Benefit	30,798	33,987	10.4%
Beneficiaries			
Number	348	378	8.6%
Average Age	72.4	72.2	(0.3)%
Total Annual Allowance	5,466,814	6,110,388	11.8%
Average Annual Benefit	15,709	16,165	2.9%
Benefit Recipients - Total			
Number	2,426	2,691	10.9%
Average Age	68.7	68.7	0.0%
Total Annual Allowance	69,465,541	84,723,411	22.0%
Average Annual Benefit	28,634	31,484	10.0%
Inactive Members*			
Number	438	673	53.7%
Average Age	45.7	44.3	(3.1)%
Total Annual Allowance	5,714,166	8,427,812	47.5%
Average Annual Benefit	13,046	12,523	(4.0)%

\* Leave of Absence included as Active in 2005 and included as Inactive in 2007

## Membership Data Distribution of Active Members and Average Pay by Age and Years of Service as of June 30, 2007

				Years of S	ervice				
Age	Under 1	1-4	5-9	10-14	15-19	20-24	25-29	30 &	Totals
	· ·····							Over	
Under 20	-	-	-	-	-	-	-	-	-
	\$0	-	-	-	-	-	-	-	\$0
20-24	28 \$44,133	14 \$48,130	- \$0	-	-	-	-	-	42 \$45,465
25-29	56 \$51,691	92 \$58,497	79 \$60,902	- \$0	-	-	-	-	227 57,655
30-34	45 \$60,659	97 \$59,761	216 \$69,132	13 \$80,786	-	-	-	-	371 66,062
35-39	39 \$59,737	78 \$66,023	270 \$71,133	93 \$75,967	44 \$73,528	- \$0	-	-	524 70,583
40-44	36 \$67,575	46 \$78,868	212 \$72,883	103 \$76,754	149 \$78,557	50 \$71,675	1 \$88,171	-	597 75,032
45-49	31 \$65,017	40 \$77,832	177 \$73,520	67 \$77,432	217 \$82,700	116 \$80,423	58 \$80,908	1 \$71,094	707 78,315
50-54	30 \$70,520	54 \$77,798	145 \$74,761	74 \$78,978	164 \$81,796	118 \$81,023	99 \$80,677	3 \$78,847	687 78,894
55-59	13 \$64,438	23 \$74,080	122 \$75,149	55 \$74,479	120 \$81,449	81 \$83,971	45 \$79,171	16 \$80,415	475 78,381
60-64	4 \$78,224	11 \$68,944	68 \$73.086	38 \$72,630	53 \$74,143	37 \$90,902	21 \$75,013	8 \$83,237	240 76,397
65&Over	1 \$77,522	3 \$89,273	18 \$65,115	19 \$69,977	16 \$66,466	10 \$70,516	4 \$71,734	1 \$80,974	72 69,215
Totals	 283 \$60,006	458 \$66,975	1,307 \$71,587	462 \$76,275	763 \$80,036	412 \$80,931	228 \$79,793	29 \$80,729	3,942 \$73,923

34

# **SECTION I** ACTUARIAL METHODS AND ASSUMPTIONS

## Actuarial Methods

<u>Actuarial Valuation Cost Method.</u> The Entry Age Normal Cost Method is used for the retirement benefits of the System.

The concept of this method is that funding of benefits for each employee should be effected as a level contribution (as a percentage of pay) from entry into the System to termination of active status.

The Normal Cost (NC) for a fiscal year under this method is determined as described in the prior paragraph for each employee. The NC for the year is the total of individual normal costs determined for each active employee.

The Actuarial Accrued Liability (AAL) under this method is the theoretical asset balance such normal costs would have accumulated to date based on current assumptions. To the extent that the assets of the fund are insufficient to cover the AAL, an Unfunded Actuarial Accrued Liability (UAAL) develops.

The actuarially calculated contribution for a year is the NC for that year plus an amount to amortize the UAAL over 30 years as a level percentage of pay.

A 15-year projection of premiums as a level percent of payroll is used to determine the Medical Insurance Contribution Rates. This is based on the Policy adopted by the Board and does not represent the calculation required under GASB 45. That calculation is provided in a separate report.

Financing of Unfunded Actuarial Accrued Liability. The balance of unfunded actuarial accrued liabilities was amortized by level (principal & interest combined) percent of payroll contributions over a 30-year period.

Active member payroll in aggregate was assumed to increase 4.0% a year for the purpose of determining the level percent contributions, although individual annual compensation increase rates will increase by at least 4.25% per year for the purpose of projecting individual benefits.

<u>Asset Valuation Method</u>. The Actuarial Value of Assets recognizes 20% of total return in excess of (or less than) the investment return assumption for each of the last five years. This method has the effect of smoothing volatility in investment returns.

The contribution requirements and benefit values of the Fund are calculated by applying actuarial assumptions to the benefit provisions and member information furnished, using the actuarial cost methods described on the previous page.

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 pay increases to members.
- (iii) rates of mortality among members, retirants, and beneficiaries.
- (iv) rates of withdrawal of active members (without entitlement to a retirement benefit).
- (v) rates of disability among members.
- (vi) the age patterns of actual retirements.

In making 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.

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 to the computed contribution rate. 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).

<u>The Investment Return Rate</u> used for the actuarial valuation calculations was 8.25% a year, net of administrative expenses, compounded annually. This assumption is used to equate the value of payments due at different points in time. The rate is comprised of two elements:

Inflation	4.00%
Real Rate of Return	4.25%
Total	8.25%

<u>The Inflation Rate</u> used for the actuarial valuation calculations was 4.00% per year compounded annually. It represents the difference between the investment return rate and the assumed real rate of return. Inflation actually experienced, as measured by the Consumer Price Index for urban wage earners, has been as follows:

Consumer Price Index Urban Wage Earner and Clerical Workers Before 1978 All Urban Consumers After 1977 <u>10 Year Moving Averages</u>

June 30, 1967	1.7%
June 30, 1977	6.2%
June 30, 1987	6.5%
June 30, 1997	3.5%
June 30, 2007	2.7%
50-Year Average	4.1%

Interest credited to member contributions is 3.0%, compounded annually.

<u>Salary Increase Rates</u> 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 Salary Increase Additional merit component Years of Service at Merit/ Longevity Inflation 4.00% Valuation Date Merit and Longevity 0.25% 0 5.50% 1 3.50% Total 4.25% 2 2.00% 3 1.50% 4 0.75%

<u>The Investment Return Rate</u> used for the actuarial valuation calculations was 8.25% a year, net of administrative expenses, compounded annually. This assumption is used to equate the value of payments due at different points in time. The rate is comprised of two elements:

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Real Rate of Return	4.25%
Total	8.25%

<u>The Inflation Rate</u> used for the actuarial valuation calculations was 4.00% per year compounded annually. It represents the difference between the investment return rate and the assumed real rate of return. Inflation actually experienced, as measured by the Consumer Price Index for urban wage earners, has been as follows:

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Interest credited to member contributions is 3.0%, compounded annually.

<u>Salary Increase Rates</u> 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 Salary Increase

Additional merit component

		Years of Service at	Merit/
Inflation	4.00%	Valuation Date	Longevity
Merit and Longevity	<u>0.25%</u>	0	5.50%
Total	4.25%	1	3.50%
		2	2.00%
		3	1.50%
		4	0.75%

#### Comparison of Selected Actuarial Assumptions to Actual Experience

The salary increase assumptions project annual increases in total member payroll of 4.0%, the inflation portion of the individual pay increase assumptions. In effect, this assumes no change in the number of active members. Changes actually experienced in areas related to these assumptions have been as follows:

	Year Ended June 30			3 Year	
	2007	2006	2005	Average	
Inflation <sup>1</sup>	3.4%	3.9%	2.0%	3.1%	
Assumed				4.00%	
Average Pay Increase	3.5%	3.5%	2.8%	3.3%	
Assumed	<u> </u>			4.00%	
Merit & Longevity Increase	0.1%	-0.4%	0.8%	0.2%	
Assumed				<u>N/A</u>	
Total Payroll	0.9%	0.9%	(1.1)%	0.2%	
Assumed				4.00%	
Investment Return Rate <sup>2</sup>	11.6%	8.1%	6.4%	8.7%	
Assumed				8.25%	
Real Rate of Investment Return	8.2%	4.2%	4.4%	5.6%	
Assumed				4.25%	
Administrative Expenses <sup>3</sup>					
(Percentage of total assets)	0.1%	0.1%	0.1%	0.1%	
Assumed				0.00%	

<sup>1</sup>Based on Annual Consumer Price Index for San Francisco-Oakland-San Jose, CA, All Items, 1982-84=100.

<sup>2</sup>Based on actuarial value of assets <u>NOT</u> market value or book value.

<sup>3</sup>Excluding Investment Fees

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

Sample Ages	Disability	Withdrawal	Vested Termination
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

#### % of Active Members Separating Within Next Year

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

 $^2$  30% of terminating employees who leave their contributions in the Plan, with 5+ years of service, are assumed to subsequently work for a reciprocal employer and receive 4.0% pay increases per year.

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

If an inactive member is not vested, the liability valued is their employee contributions with interest.

<u>The post-retirement mortality table</u> 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. Related values are shown below.

				% of ]	Benefit Reci	ipients
	Future	Life Expects	ancy (Years)	Dy	ing Each Y	ear
	Re	etired		Reti	red	
Sample Ages	<u>Men</u>	<u>Women</u>	<b>Disabled</b>	Men	<u>Women</u>	<b>Disabled</b>
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

<u>The active member mortality</u> 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

Sample Ages	<u>Men</u> 06%	Women 05%
35	.06	.0570
40	.07	.05
45	.09	.08
50	.16	.13
55	.26	.20
60	.38	.30
65	.53	.44

## GRS

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

% of Active Members Separating Within Next Year<sup>1</sup>

#### **Retirement Ages**

50	%
51	%
52	%
53	%
54	%
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>Superceded by 50% retirement probability each year after completion of 30 years of service and attainment of age 50.

Disability Benefit Offset. Workers' Compensation Benefits are assumed to not be an offset.

<u>Survivor Benefits</u>. Marital status and spouses' census data were imputed with respect to active and deferred members.

<u>Marital Status</u> :	75% of men (85% in the previous valuation) and 55% of
	women (60% in the previous valuation) were assumed married
	at retirement.

Spouse Census: Women were assumed to be 3 years younger than men.

"Spouse" is assumed to encompass a registered domestic partner.

Member Contributions. 4% per year assumed.

#### Health Subsidy Benefits

Increase in Retiree Population:

The covered Retiree population is assumed to increase 6.10% per year.

Covered Payroll Increase:

4.0% per year.

Medical and Dental Trend Rate:

7.50%

# **SECTION J** DEFINITIONS OF TECHNICAL TERMS

### DEFINITIONS OF TECHNICAL TERMS

<u>Actuarial Accrued Liability</u>. 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".

<u>Actuarial Assumptions</u>. 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.

<u>Accrued Service</u>. Service credited under the system which was rendered before the date of the actuarial valuation.

<u>Actuarial Equivalent</u>. 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.

<u>Actuarial Cost Method</u>. 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".

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

<u>Actuarial Present Value</u>. 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.

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

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

## DEFINITIONS OF TECHNICAL TERMS

<u>Unfunded Actuarial Accrued Liability</u>. 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). Unfunded actuarial accrued liability should be controlled.



GRS Gabriel Roeder Smith & Company Consultants & Actuaries

CITY OF SAN JOSE FEDERATED RETIREE HEALTH CARE PLAN ACTUARIAL VALUATION REPORT AS OF JUNE 30, 2007

## TABLE OF CONTENTS

Section	Page Number	
		Cover Letter
		Executive Summary
	1-3	Executive Summary
Α	1-2 3 4 5	OVERVIEW OPEB Specific Assumptions Actuarial Cost Method OPEB Prefunding OPEB Funding Policy
В		VALUATION RESULTS
	1-2 3 4 5-7	Development of the Annual Required Contribution Reconciliation of the Annual Required Contribution Determination of Unfunded Actuarial Accrued Liability Comments
С		<b>RETIREE PREMIUM RATE DEVELOPMENT</b>
	1-2	Retiree Premium Rate Development
D		SUMMARY OF ASSETS
	1-2	Summary of Assets
E		SUMMARY OF BENEFITS
	1-2	Summary of Benefits
F		SUMMARY OF PARTICIPANT DATA
	1 2 3	Schedule of Active Members Schedule of Retired Members Schedule of Deferred Vested Members
G		ACTUARIAL COST METHOD AND ACTUARIAL ASSUMPTIONS
	1 2-6 7	Valuation Methods Actuarial Assumptions Miscellaneous and Technical Assumptions
Appendix A Appendix B	1-2	Glossary OPEB Funding Approval Letter

# GRS

Gabriel Roeder Smith & Company Consultants & Actuaries 7900 East Union Avenue Suite 1100 Denver, CO 80237-2746 303.217.7600 phone 303.217.7609 fax www.gabrielroeder.com

February 6, 2009

Mr. Russell Crosby City of San Jose Department of Retirement Services 1737 N. First Street, Suite 580 San Jose, CA 95112-4505

Dear Mr. Crosby:

Submitted in this report are the results of an Actuarial Valuation of the assets and benefit values associated with the employer financed retiree health benefits provided by the City of San Jose for their Federated employees. The date of the valuation was June 30, 2007. The annual required contribution has been calculated for the fiscal year beginning July 1, 2008 and is based on the funding policy stated in the Municipal Code.

The basis for the valuation of liabilities is the cost sharing arrangement described in the City of San Jose Municipal Code. The use of the cost sharing arrangement as defined in the Municipal Code has been requested by Staff and we understand has received approval from the auditors.

The valuation was based upon information, furnished by the City, concerning retiree health benefits and individual employees, and financial data. 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. One or more of the undersigned are members of the American Academy of Actuaries and meet the Qualification Standards of the Academy of Actuaries to render the actuarial opinion herein.

Respectfully submitted,

desuid Thompson

Leslie L. Thompson, FSA, FCA, EA, MAAA Senior Consultant

Susan Mithogarth-

Susan Hogarth, EA, MAAA Consultant

# **EXECUTIVE SUMMARY**

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#### **Annual Required Contribution**

This report presents the annual expense based on actuarial funding methods described in the Government Accounting Standards Board Statement No. 45, and in compliance with the City Municipal Code.

The Annual Required Contribution (ARC), payable by the City for the fiscal year beginning July 1, 2008 has been calculated. Below is a summary of the Annual Required Contribution.

	6/30/2007 (6.60%)	As a % of Pavroll	6/30/2006 (5.60%)	As a % of Pavroll
Payroll	\$271,832,564	<u>~ ~ ~ ~ ~ ~ ~ ~ ~ ~ ~ ~ ~ ~ ~ ~ ~ ~ ~ </u>	\$275,558,882	<u> </u>
Implicit Rate Subsidy*	\$1,647,538	0.6%	\$1,551,337	0.6%
City Contribution	\$20,145,444	7.4%	\$36,974,701	13.4%
Annual Required Contribution	\$21,792,982	8.0%	\$38,526,038	14.0%
Employee Contribution	<u>\$19,571,813</u>	7.2%	<u>\$8,318,074</u>	3.0%
Total Contribution	\$41,364,795	15.2%	\$46,844,112	17.0%

Based upon instructions from staff, the employee contribution amount of \$19,571,813 in the fiscal year ending 2007 includes the expected contributions of \$7,983,818, plus an additional receivable of \$11,587,995. We make no assertion that these additional contributions will be made. We recognize that by scheduling these contributions as employee contributions that there has been a similar reduction in the employer liability. However, the intent of this illustration is to provide OPEB liabilities and the employer ARC that reflect the cost sharing arrangement described in the Municipal Code.

This calculation is based on the policy stated in the Municipal Code – that the liabilities and costs are to be split 50%/50% for medical costs and in a ratio of 8:3 for the dental costs (City to employees). The policy as of the valuation date was based on a different funding method and the employee contributions were less than those that would have been produced under the Municipal Code policy. As instructed, we have posted the difference as an additional employee contribution but we have not received any indication for when those contributions could be made.

	Total	Medical	Dental
Total Contribution	\$41,364,795	\$36,478,222	\$4,886,573
Employee Contribution at Current Policy Rate	\$7,983,818	\$6,942,206	\$1,041,612
Additional Employee Contribution	\$11,587,995	<u>\$11,296,905</u>	\$2 <u>91,090</u>
Total Employee Contribution	\$19,571,813	\$18,239,111	\$1,332,702
Total City Contribution	\$21,792,982	\$18,239,111	\$3,553,871

\*Implicit Rate Subsidy is the discounted price built into the retiree health care premiums by pooling the retiree actual claims experience with the active employee actual claims experience. Retiree health care premiums would be higher in the absence of the pooling. Although not a cash expense, this is an accounting expense that is required to be recognized by the GASB 45 statement.

For additional details please see Section B of the report.

#### **Additional OPEB Reporting Requirements**

The City will have to disclose a Net OPEB Obligation (or asset). The Net OPEB Obligation is the cumulative difference between annual OPEB costs and annual employer contributions in relation to the ARC, accumulated from the implementation of Statement No. 45. The Net OPEB Obligation is zero as of the beginning of the fiscal year that Statement No. 45 is implemented, unless the City chooses to recognize a beginning balance. The requirements for determining the City's contributions in relation to the ARC are described in paragraph 13g. of Statement No. 45. Additional information required to be disclosed in the employer's financial statements is detailed in paragraphs 24 through 27 of Statement No. 45.

#### Liabilities and Assets

The present value of all benefits expected to be paid to current plan members as of June 30, 2007 is \$760,865,557. The actuarial accrued liability, which is the portion of the \$760,865,557 attributable to service accrued by plan members as of June 30, 2007, is \$616,748,714. As of June 30, 2007, there is \$96,601,000 in valuation assets available to offset the liabilities of the plan.

The funded status of the plan, which is the ratio of plan assets to actuarial accrued liability, as of June 30, 2007 is 15.66%.

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# SECTION A OVERVIEW

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#### **OPEB SPECIFIC ASSUMPTIONS**

In any long-term actuarial valuation (such as for pensions and OPEB) certain demographic, economic and behavioral assumptions must be made concerning the population, investment discount rates, and the benefits provided. These actuarial assumptions form the basis for the actuarial model which is used to project the future population, benefits to be provided, and contributions to be collected. The investment return rate assumption is used to discount the future benefits to a present value on the valuation date. While assumptions such as future rates of retirement and mortality are similar for both OPEB and pension plans, there are some additional assumptions required when projecting benefits for a health care plan.

The cost of providing medical services has been increasing more rapidly than prices in general for many years. During the period from 1955 to 2005 general inflation averaged 4.0%, while health expenditures increased by an average of about 10% per year. 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. The seemingly more reasonable alternative is that in the not too distant future medical expense inflation will stabilize at a level at or near general inflation. It is on this basis that we project that retiree health care costs will continue to exceed general inflation in the near term, but by less each year until leveling off at an ultimate rate that is similar to general price increases.

Health care increase rates used in this valuation lie within a range of reasonable assumptions, and are described in Section G of this report. The health care increase rate assumption has a major effect on the calculation of plan liabilities. To illustrate the effect of differing future medical inflation rates, the following chart projects the growth of \$1 of health care benefit under three sets of assumptions.

In this illustration, each set of assumptions trends smoothly to an assumed long term rate of inflation over the next ten years: The assumption set labeled "Pessimistic" begins at a rate of 10% in excess of general inflation, the "Intermediate" assumption begins at a rate of 7% in excess of general inflation, while the "Optimistic" assumption begins at a rate of 3% in excess of general inflation.



The chart above shows that the cost of providing health care is expected to increase over 50% in inflation-adjusted dollars over the next 20 years, using the "Intermediate" health care increase assumption set. To put this in perspective, assuming health care increases are brought under control almost immediately, as in the "Optimistic" assumption set, implies future per capita health care costs will be expected to increase less than 20% over current levels. In addition to the per capita health care inflation, costs are expected to rise as the retiree population increases.

It is important to note that GASB Statements No. 43 and No. 45 require the selection of an interest rate assumption to be based on the expected long-term rate of return on the assets expected to pay the OPEB when due. GASB states that the return should be based on expected returns of:

- Plan assets if the sponsor has been contributing the ARC on a regular basis;
- The employer's general assets where no OPEB assets have been accumulated;
- A blend of plan and employer assets in cases where OPEB assets exist but the plan is contributing amounts less than the ARC.

#### **ACTUARIAL COST METHOD**

GASB Statement No. 45 provides some flexibility to governmental employers (and their actuaries) in the use of various actuarial cost methods. It should be noted that an actuarial cost method determines a contribution or expense by assigning portions of the present value of projected benefits to various years with the general goal of accruing the cost of benefits over the working lifetime of the employees. The choice of a particular method does not change the ultimate cost of the promised benefits.

The Entry Age Normal, Level Percent of Payroll actuarial cost method has been used to calculate the GASB ARC for this valuation. Using the plan benefits, the present health premiums and a set of actuarial assumptions, the anticipated future payments are projected. The entry age method then provides for a systematic funding for these anticipated payments. The yearly ARC is computed to cover the cost of benefits being earned by covered members as well as to amortize a portion of the unfunded accrued liability. If experience is in accordance with the assumptions used, the ARC will increase at approximately the same rate as active member payroll, and the ARC as a percentage of payroll will remain basically level on a year to year basis. This is both an acceptable and reasonable cost method. The use of another actuarial cost method would produce different results.

#### **OPEB PREFUNDING**

Many employers fund retiree heath care benefits using the pay-as-you-go (or cash disbursement) method. The employer's annual contribution for these benefits is equal to the actual disbursements during the year for health care benefits for retired employees. This method of funding will result in increasing contributions over time. First, per capita cash disbursements will tend to increase from year to year as the cost of health care services, or the utilization of these services, increases. Second, the number of retired members is likely to increase for years to come. The more retirees, the greater the disbursements as a percentage of employee payroll.

A retiree health care plan is similar to a defined benefit pension plan, in that promises are made to employees to provide them with a benefit payable at some future date. For defined benefit pension plan sponsors a common funding objective is to contribute annual amounts to a fund which will i) remain level as a percentage of active member payroll, and ii) when combined with present assets and future investment return will be sufficient to meet the financial obligations of the Plan to current and future retirees.

The ultimate determination as to the level of pre-funding will be the result of decisions made in an attempt to reconcile the often conflicting needs of benefit security for members and fiscal responsibility for the Municipality. The GASB accounting standards noted in the previous section of the report can factor into decisions concerning the level of pre-funding. Currently, the plan is "partially pre-funded", using a funding policy that has been established by the Board and is reflected in the annual valuation for the Federated City Employees' Retirement Plan.

#### **OPEB FUNDING POLICY**

The new funding method is described under the following Municipal Code section:

#### 3.28.380 Medical benefits account.

A. There is hereby established the medical benefits account as a separate account within the retirement fund. The medical benefits account shall be maintained in compliance with Internal Revenue Code Section 401(h) and the regulations promulgated thereunder. Monies in the medical benefits account may be commingled with other monies in the retirement fund solely for the purposes of investment.

B. All contributions made to the retirement fund to provide for the payment of benefits for sickness, accident, hospitalization, dental or medical expenses of persons receiving monthly allowances under the provisions of this system, and all earnings and interest attributable to such contributions, shall be placed in the medical benefits account. All contributions to the medical benefits account shall be reasonable and ascertainable. At the time the city makes a contribution to the medical benefits account, the city shall designate in writing that such contribution is solely for the medical benefits account.

C. Contribution rates to fund the benefits for sickness, accident, hospitalization, dental or medical expenses shall be established by the board as determined by the board's actuary and shall be borne by the city and the members of the plan as follows:

1. Contributions for dental benefits shall be made by the city and the members in the ratio of eight-to-three.

2. Contributions for medical and dental insurance premiums costs attributable to the early retirement incentive programs described in Parts 18, 19, and 20 of this chapter shall be borne by the city.

3. Contributions for other benefits provided through the medical benefits account shall be made by the city and the members in the ratio of one-to-one.

# **SECTION B** VALUATION RESULTS

#### SAN JOSE FEDERATED DEVELOPMENT OF THE ANNUAL REQUIRED CONTRIBUTION

Contributions for	Development of the Annual Required Contribution		
	<u>2007</u>	<u>2006</u>	
Total Normal Cost	\$16,818,925	\$21,015,906	
Less Employee Contribution towards Normal Cost	<u>\$7,910,760</u>	<u>\$8,318,074</u>	
Employer Normal Cost	\$8,908,165	\$12,697,832	
Amortization of UAL*	\$24,545,870	\$25,828,206	
Less Employee Contribution towards Amortization of UAL*	<u>\$11,661,053</u>	\$0	
Employer Amortization of UAL	\$12,884,817	\$25,828,206	
Annual Required Contribution (ARC)	\$21,792,982	\$38,526,038	
ARC Per Active Participant	\$5,561	\$10,114	
Payroll	\$271,832,564	\$275,558,882	

\* Unfunded Actuarial Accrued Liabilities (UAL) were amortized over 30 years. The employee contribution for 2007 payable towards the normal cost and the amortization of the UAL is based upon the cost sharing arrangement described under the San Jose Municipal Code.

The ARC shown in this report has been calculated to increase at the same rate as the projected increase in active member payroll (4.00% per year). The unfunded actuarial accrued liabilities were amortized as a level percent of active member payroll over an open period of 30 years. A 30-year amortization period for unfunded actuarial accrued liabilities is the maximum period that complies with the GASB requirements. The rates shown are based on a 5.60% discount rate for 2006, a 6.60% discount rate for 2007 and the Entry Age Normal cost method.

Effective with the June 30, 2007 valuation, the funding policy shown is based on the Municipal Code, with costs and liabilities split between the City and the employees at 50%/50% for medical costs and dental costs 8/11 for the City and 3/11 for the employee.

## SAN JOSE FEDERATED RECONCILIATION OF THE ANNUAL REQUIRED CONTRIBUTION

June 30, 2006 OPEB Employer Contribution Rate		
Decrease due to investment gains	(0.14%)	
Increase due to retirements	0.08%	
Decrease due to open amortization period	(0.14%)	
Decrease due to smaller retiree medical premium increases than expected	(0.21%)	
Increase due to increase in participation assumption	0.60%	
Increase due to policy contribution made vs. ARC	0.33%	
Increase due to post-retirement mortality loss	0.03%	
Decrease due to increase in discount rate	(1.90%)	
Decrease due to cost sharing arrangement*	(4.26%)	
Other miscellaneous factors	<u>(0.35%)</u>	
Total Change in Contribution Rate		(5.96%)
June 30, 2007 OPEB Employer Contribution Rate	8.02%	

\*ARC for 2007 was calculated based on the cost sharing arrangement described under the San Jose Municipal Code. ARC for 2006 was calculated based on a 2.98% net employee contribution rate.

The June 30, 2006 OPEB employer contribution rate is determined using a 5.60% discount rate and an entry-age normal funding method. The discount rate used for the June 30, 2007 rate is 6.60% and the funding method used was entry-age normal.

## SAN JOSE FEDERATED DETERMINATION OF UNFUNDED ACTUARIAL ACCRUED LIABILITY AS OF JUNE 30, 2007

	2007	<u>2006</u>
A. Present Value of Future Benefits i) Retirees and Beneficiaries	\$319.244.103	\$357.851.959
ii) Vested Terminated Members	\$16,554,107	\$13,034,246
iii) Active Members	<u>\$425,067,347</u>	<u>\$525,886,790</u>
Total Present Value of Future Benefits	\$760,865,557	\$896,772,995
B. Present Value of Future Total Normal Costs	\$144,116,843	\$193,834,330
C. Actuarial Accrued Liabilities (AB.)	\$616,748,714	\$702,938,665
D. Actuarial Value of Assets	\$96,601,000	\$81,288,000
E. Unfunded Actuarial Accrued Liability (CD.)	\$520,147,714	\$621,650,665
F. Funded Ratio (D./C.)	15.66%	11.56%

The Unfunded Actuarial Accrued Liability (UAAL) is not booked as an expense all in one year and does not appear in the Employer's Statement of Net Assets. Nevertheless, it is reported in the Notes to the Financial Statements and in the Required Supplementary Information. These are information sections within the employer's financial statements.

#### **COMMENTS**

**COMMENT A:** One of the key assumptions used in any valuation of the cost of post-employment benefits is the rate of return on Plan assets. Higher assumed investment returns will result in a lower liability. Lower returns will tend to increase the liabilities. Based on information from the plan sponsor we have calculated the liability and the resulting ARC using a 6.60% assumed return, net of investment and administrative fees. If the Plan Sponsor chooses to pre-fund with contributions equal to or greater than the ARC, GASB allows the use of a higher rate of return on assets. Use of such an interest rate would considerably decrease the ARC and the net OPEB obligation that is disclosed on the employers' financial statement. We have calculated the ARC based on the 6.60% assumed return and the newly developed funding policy to be \$21,792,982. We have calculated the ARC to be \$18,038,424 using an assumed return of 8.25%. This represents a decrease in the net OPEB obligation of \$3,754,558.

The 6.60% discount rate was developed by recognizing that the OPEB benefits are being funded at a level higher than merely paying the premiums. GASB allows plans to recognize partial prefunding by using a discount rate that ranges between the risk free rate and the full funding rate. Last valuation, the ARC was valued using a 5.60% discount rate. Since the contribution rate paid by the City has increased, and has increased relative to the required ARC, the discount rate has been increased from 5.60% to 6.60%. This increase is due to two primary factors- the current year prefunding, and the institution of a new funding policy for the determination of the City contribution creates the higher contribution relative to the ARC.

**COMMENT B:** Based on the number of plan members as of this valuation, the plan sponsor is required by GASB to perform actuarial valuations at least biennially. An actuarial valuation will recompute the required contribution rate each valuation. This will permit fluctuations and trends in experience to be reflected in the contribution rate on a regular basis.

**COMMENT C:** The contribution rates shown include amortization of the unfunded actuarial accrued liability over an open period of 30 years. This is the maximum time period permitted by the

Governmental Accounting Standards Board Statement No. 43 and No. 45. A shorter amortization period would result in a higher ARC.

**COMMENT D:** 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 short term medical inflation assumption has been decreased to reflect the favorable experience. The previous valuation assumed at 12%, graded down to 4.5%. This valuation assumes medical trend at 8%, graded down to 4.5%. The 8% initial trend is based on analysis by the City staff of observed trends in the last few years.

**COMMENT E:** 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 C-1 shows the gross age-adjusted premiums.

**COMMENT F:** The ARC is net of the employee contributions and the additional employee (receivable) contributions to retiree medical coverage. This valuation reflects a change in the assumed employee contributions to reflect the cost sharing arrangement under the Municipal Code and staff has indicated that these contributions are expected to continue in the future under this arrangement. We have reduced the normal cost component and the amortization of the UAL component of Annual Required Contribution by the amount of anticipated employee contributions, 7.2% of payroll. The present value of all future employee contributions is \$145,589,181.

**COMMENT G:** There were 150 members as of June 30, 2007 who terminated employment with a temporary status of "Leave of Absence" (LOA). Staff has indicated in the past that members with this status are eventually re-categorized depending on their situation: disability retirement, deferred retirement, return of contributions, etc., and that a fairly low percentage would return to work. Therefore, 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 2007 pension valuation but was excluded in the 2006 health care valuation.

**COMMENT H:** 144 retired members are in this plan who have less than 15 years of service, 98 of which retired under the disability provision, 33 who are eligible for coverage but are not eligible for the City provided subsidy (100% of the lowest cost health plan) and therefore pay their full premium, and the other 13 either received golden handshakes or are covered under an eligible continuance record.

**COMMENT I:** The following assumption was changed from the prior valuation – the assumed rate of participation was increased from 85% to 100% of eligible retirees.

COMMENT J: The Municipal Code establishes a policy for contributions as follows:

- 1. Contributions for dental benefits shall be made by the City and the members in the ratio of eight to three.
- 2. Contributions for other benefits provided through the medical benefits account shall be made by the City and the members in the ratio of one to one.

See page A-5 for additional detail under the Code. Although this report does not set the contribution rates, it does reflect the amounts to be expensed. On page 2 of this report, we have illustrated the expense amounts as if this policy were also in effect for these amounts.

Actual contributions are developed in the valuation of the pension plan for Federated City employees based on a non-standard method that is wholly different than that prescribed under GASB.

The method is based on a projection of expected medical and dental premiums discounted back to the valuation date with a 7.5% discount rate.

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# SECTION C RETIREE PREMIUM RATE DEVELOPMENT

### **RETIREE PREMIUM RATE DEVELOPMENT**

The initial per capita costs were developed for the two classes of retirees (pre-65 and post-65) using fully insured premium rates in conjunction with census data for the active and retired members of the retiree health care program.

The costs developed based on the actual experience are used for both current and future retirees for all plans combined. An inherent assumption in this methodology is that the projected future retirees will have a similar distribution by plan type to the current retirees.

Age graded and sex distinct premiums are utilized by this valuation. These costs are appropriate for the unique age and sex distribution currently existing. Over the future years covered by this valuation, the age and sex distribution will most likely change. Therefore, our process "distributes" the average premium over all age/sex combinations and assigns a unique premium for each combination. The age/sex specific costs more accurately reflect the health care utilization and cost at that age.

The imputed age-based monthly one-person premium including medical and prescription drug benefits at select ages are shown below:

FOR THOSE NOT ELIGIBLE FOR MEDICARE				
Age	MALE	FEMALE		
40	\$199.09	\$311.93		
50	365.97	414.67		
60	600.90	577.60		
64	699.42	648.30		

FOR THOSE ELIGIBLE FOR MEDICARE				
AGE	MALE	FEMALE		
65	\$367.10	\$338.05		
75	470.10	417.20		
85	524.19	460.21		

<u>Dental Premium</u>: Based on census data for current retiree dental plan participants (see page F-2); 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 \$97.94.

### **RETIREE PREMIUM RATE DEVELOPMENT**

Based on the guidance provided by GASB on issues related to Medicare Part D payments to State and Local Governments effective June 30, 2006, an employer should apply the measurement requirements of GASB Statement No. 45 to determine the actuarial accrued liabilities, the annual required contribution of the employer, and the annual OPEB cost without reduction for Retiree Drug Subsidy (RDS) payments. Therefore, the impact of the RDS that is part of the Medicare Prescription Drug Improvement and Modernization Act of 2003 is not reflected in this report.

# **SECTION D** SUMMARY OF ASSETS

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## SAN JOSE FEDERATED SUMMARY OF ASSETS AS OF JUNE 30, 2007

### Statement of Plan Net Assets June 30, 2007 (\$ in 000's)

	Healthcare	
ASSETS		
Receivables		
Employee Contributions	\$	364
Employer Contributions		428
Brokers and Others		4,908
Accrued Investment Income		354
		6,054
Investments		
Short Term Funds		4,110
Short Term Currency Investments		(2)
Government Debt Securities		18,312
Corporate Debt Securities		12,842
Equities		59,751
Real Estate		4,192
Securities Lending Pool		10,132
		109,337
Total Assets	\$	115,391
Liabilities		
Payable to Brokers		8,574
Securities Lending Collateral Due		10,132
Other Liabilities		84
Total Liabilities	\$	18,790
Net Assets Available For Benefits	\$	96,601

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## SAN JOSE FEDERATED SUMMARY OF ASSETS AS OF JUNE 30, 2007

## Statement of Changes in Plan Net Assets For the Fiscal Year Ended June 30, 2007

(\$ in 000's)

	Post-Employement <u>Healthcare</u>	
ADDITIONS		
Contributions		
Employee Contributions	\$	9,612
Employer Contributions		10,728
		20,340
Investment Income		
Net Appreciation		11,349
Dividends and Interest		2,109
Net Rental Income		212
Investment Expense		(353)
Net Securities Lending Income		26
		13,343
Total Additions	\$	33,683
DEDUCTIONS		
Retirement Benefits		0
Health Insurance Premiums		18,265
Death Benefits		0
Refunds		0
Administrative Expenses		105
Total Deductions	\$	18,370
NET ASSETS AVAILABLE FOI	R BENEFI	TS
Beginning of Year	\$	81,288
End of Year	\$	96,601

# **SECTION E** SUMMARY OF BENEFITS

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### SAN JOSE FEDERATED SUMMARY OF BENEFITS AS OF JUNE 30, 2007

#### 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 compensation.

Employees who become disabled and have 15 years of service or have a monthly pension equal to at least 37.5% of final compensation.

Spouse/domestic partners of retired members who are qualified for medical are eligible to receive coverage if married or in a registered domestic partnership 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 or be receiving a monthly pension equal to at last 37.5% of final compensation; and
- be 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 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 dental plan at the time of death; and
- the survivor will receive a monthly pension allowance.

### SAN JOSE FEDERATED SUMMARY OF BENEFITS AS OF JUNE 30, 2007

#### B. Benefits

#### MEDICAL

The Retirement System, through the medical benefit account, 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, 2007 the lowest cost health plan is Kaiser; family coverage is \$999.40 and single coverage is \$401.36 per month.

#### DENTAL

The Retirement System, through the medical benefit account, pays 100% of the dental insurance premiums.

C. <u>Retiree Premium Rates</u>: Monthly rates used for 2007 are shown below.

	Effecti	ve January 1, 2	007	
MEDICAL	Single	Increase	Family	Increase
	-	<u>from 2006</u>		<u>from 2006</u>
Non-Medicare Monthly Rates				
Kaiser – Traditional (CA)	\$401.36	6.35%	\$999.40	6.35%
Blue Shield HMO	\$399.28	4.85%	\$1,025.64	4.85%
Blue Shield POS or PPO	\$607.08	7.72%	\$1,560.12	7.72%
Supplemental				
Medicare Monthly Rate				
Kaiser – Senior Advantage	\$385.53	12.70%	\$771.06	12.70%
Secure Horizons–Medicare+Choice	\$365.75	15.84%	\$731.50	15.84%
Blue Shield – Medicare PPO	\$471.78	8.66%	\$943.56	8.66%
Blue Shield – Medicare HMO	\$301.21	5,75%	\$602.42	5.75%
DENTÀL				
Delta Dental PPO	\$99.42	1.61%	\$99.42	1.61%
Delta Care PMI	\$50.10	0.00%	\$50.10	0.00%

**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.

# SECTION F SUMMARY OF PARTICIPANT DATA

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## SAN JOSE FEDERATED TOTAL ACTIVE MEMBERS AS OF JUNE 30, 2007 BY ATTAINED AGE AND YEARS OF SERVICE

		Years of Service to Valuation Date						
Attained Age	0-4	5-9	10-14	15-19	20-24	25-29	30 Plus	Total
		7		·				
Under 20	1	1						1
20-24	41	2						43
25-29	133	113	3					249
30-34	127	231	30	l I				388
35-39	111	250	97	63	1			522
40-44	88	207	91	158	71	1		616
45-49	63	164	69	210	114	75	[ ]	695
50-54	78	158	74	159	110	90	5	674
55-59	37	117	58	108	80	36	15	451
60-64	15	63	38	46	29	15	8	214
65 & Over	5	14	20	11	12	2	2	66
Totals	699	1,319	480	755	417	219	30	3,919

Average Age:	45.5	years
Average Service:	11.7	years

### SAN JOSE FEDERATED TOTAL RETIRED MEMBERS AS OF JUNE 30, 2007 BY ATTAINED AGE

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Attained	Number of Retirees			
Age	Male	Female	Total	
Under 55	58	61	119	
55-59	206	156	362	
60-64	215	177	392	
65 & Over	619	484	1,103	
Totals	1,098	878	1,976	

Medical

Attained	Number of Retirees			
Age	Male Female Tot			
Under 55	60	62	122	
55-59	188	147	335	
60-64	219	189	408	
65 & Over	713	670	1,383	
Totals	1,180	1,068	2,248	

The number counts above only include those retirees who have elected to receive retiree health care coverage through the San Jose Federated Retiree Health Care Plan.

## SAN JOSE FEDERATED TOTAL DEFERRED VESTED MEMBERS AS OF JUNE 30, 2007 BY ATTAINED AGE

Attained	Number of Deferred Vested		
Age	Male	Female	Total
Under 55	43	30	73
55-59	2	2	4
60-64	0	0	0
65 & Over	0	0	0
Totals	45	32	77

# SECTION G ACTUARIAL COST METHOD AND ACTUARIAL ASSUMPTIONS

### VALUATION METHODS FOR SAN JOSE FEDERATED AS OF JUNE 30, 2007

Actuarial Cost Method. Normal cost and the allocation of benefit values between service rendered before and after the valuation date was determined using an Individual Entry-Age Actuarial Cost Method having the following characteristics:

- (i) the annual normal cost for each individual active member, payable from the date of employment to the date of retirement, is sufficient to accumulate the value of the member's benefit at the time of retirement;
- (ii) each annual normal cost is a constant percentage of the member's year by year projected covered pay.

Actuarial gains (losses), as they occur, reduce (increase) the Unfunded Actuarial Accrued Liability

*Financing of Unfunded Actuarial Accrued Liabilities.* Unfunded actuarial accrued liabilities (UAAL) (full funding credit if assets exceed liabilities) were amortized by level (principal & interest combined) percent-of-payroll contributions. The UAAL was determined using the funding value of assets and actuarial accrued liability calculated as of the valuation date. The UAAL amortization payment (one component of the contribution requirement), is the level percent-of-payroll required to fully amortize the UAAL over an open 30 year period.

Actuarial Value of System Assets. The Actuarial Value of Assets is set equal to the reported market value of assets.

*Cost Allocation between City and the Employees.* The actual employee contributions were based on a policy method that splits costs in accordance with the Municipal Code for that policy (see the Federated Retirement Plan actuarial valuation). To make up the deficit in this valuation, we received instruction to post an additional employee contribution receivable in the contribution calculation. This same receivable has not been posted to the assets.

### ACTUARIAL ASSUMPTIONS FOR SAN JOSE FEDERATED AS OF JUNE 30, 2007

The rate of investment return was 6.60% a year, compounded annually net after investment and administrative expenses. For instance, if expenses are 0.60%, then the gross rate of return needed to meet the assumption is 7.20%.

The 6.60% return assumption is a blend between the risk-free rate of 4.50% and a full-funding rate of 8.25%. The GASB allows the blended rate to be used where there is a partial pre-funding of the benefits.

The assumed real return is the rate of return in excess of price inflation. Considering other assumptions used in the valuation, the 6.60% nominal rate translates to a net real return of 2.60% per year.

*The payroll growth rate* for financing Unfunded Actuarial Accrued Liabilities was assumed to be 4.00% per year. This is the rate at which payroll for the total population is assumed to grow each year. It is not the salary increase rate assumed for any one individual member.

*The rates of post retirement mortality* used for individual members are in accordance with the following tables.

For normal retirees, the probabilities of dying at sample attained ages were as follows (from the 1994 Group Annuity Mortality Table [sex distinct]):

Sample Attained	Probability of Dying Next Year		Future Life Expectancy (years)	
Ages	Men	Women	Men	Women
50	0.26%	0.14%	30.69	34.89
55	0.44	0.23	26.15	30.17
60	0.80	0.44	21.83	25.59
65	1.45	0.86	17.84	21.28
70	2.37	· 1.37	14.29	17.30
75	3.72	2.27	11.12	13.60
80	6.20	3.94	8.37	10.31

For disabled retirees, the probabilities of dying at sample attained ages were as follows (from the 1981 Disability Mortality Table):

Sample Attained	Probabilit Next	Probability of Dying Next Year		
Ages	Men	Women		
50	2.44%	2.44%		
55	2.84	2.84		
60	3.30	3.30		
65	3.79	3.79		
70	4.37	4.37		
75	5.53	5.53		
80	<u>8.7</u> 4	8.74		

These assumptions are used to measure the probabilities of each benefit payment being made after retirement.

*The rates of mortality for active members* were established based on actual plan experience. The rates are in accordance with the following table.

Sample Attained	Probability Death N	Probability of Ordinary Death Next Year	
Ages	Men	Women	
-			
35	0.06%	0.05%	
40	0.07	0.05	
45	0.09	0.08	
50	0.16	0.13	
55	0.26	0.20	
60	0.38	0.30	
65	0.53	0.44	

*The rates of retirement* used to measure the probability of eligible members retiring during the next year were as follows:

Retirement	Rates of
Ages	Retirement*
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

\* Superceded by 50% retirement probability each year after completion of 30 years of service and attainment of age 50.

*Rates of separation from active membership* were as shown below (rates do not apply to members eligible to retire and do not include separation on account of death). This assumption measures the probabilities of members remaining in employment.

% of Active Members Separating Within Next Year				
Sample			Vested	
<u>Ages</u>	<u>Disability*</u>	<u>Withdrawal</u>	<b><u>Termination</u></b>	
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	

\* 50% of the disabilities are assumed to be duty-related and 50% are assumed to be non-duty related.

	Pre and Post Commencement		
	Health Care Trend Inflation Rates		
Year	Medical and Drug	Dental	
2007	8.0%	6.0%	
2008	7.5	6.0	
2009	7.0	5.5	
2010	6.5	5.5	
2011	6.0	5.0	
2012	5.5	5.0	
2013	5.0	4.5	
2014	4.5	4.5	
2015	4.5	4.0	
2016	4.5	4.0	
2017	4.5	4.0	
2018	4.5	4.0	
2019	4.5	4.0	
2020	4.5	4.0	
2021	4.5	4.0	
2022	4.5	4.0	

Health cost increases for active members are displayed in the following table:

## MISCELLANEOUS AND TECHNICAL ASSUMPTIONS FOR San Jose Federated As of June 30, 2007

Administrative Expenses	No explicit assumption has been made for administrative expenses.	
Eligibility Testing	Eligibility for benefits is determined based upon the age nearest birthday and service nearest whole year on the date the decrement is assumed to occur.	
Incidence of Contributions	Contributions are assumed to be received continuously throughout the year based upon the computed percent of payroll shown in this report, and the actual payroll payable at the time contributions are made.	
Marriage Age Difference Assumption	Male spouses are assumed to be three years older than female spouses for active member valuation purposes.	
Medicare Coverage	Assumed to be available for all covered employees on attainment of age 65.	
Election Percentage	It was assumed that all retirees would choose to receive retiree health care benefits through the Employer (this was changed from the prior assumption of 85%). Of those assumed to elect coverage, 55% of males and 55% of females were assumed to elect two-person medical coverage (65% of males and 65% of females were assumed to elect two-person dental coverage), if eligible. For those that elect two-person coverage, it was assumed that coverage would continue to the spouse upon death of the retiree, if eligible.	
Deferral Age	Medical insurance payments for vested members who terminate commence at age 58.	

# APPENDIX A

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Accrued Service. The service credited under the plan which was rendered before the date of the actuarial valuation.

Actuarial Accrued Liability. The difference between (i) the actuarial present value of future plan benefits, and (ii) the actuarial present value of future normal cost. Sometimes referred to as "accrued liability" or "past service liability."

Actuarial Assumptions. Estimates of future plan experience with respect to rates of mortality, disability, turnover, retirement, rate or rates of investment income and salary increases. Decrement 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.

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

Actuarial Equivalent. A single amount or series of amounts of equal value to another single amount or series of amounts, computed on the basis of the rate(s) of interest and mortality tables used by the plan.

Actuarial Present Value. The amount of funds presently required to provide a payment or series of payments in the future. It is determined by discounting the future payments at a predetermined rate of interest, taking into account the probability of payment.

**Amortization.** Paying off an interest-bearing liability by means of periodic payments of interest and principal, as opposed to paying it off with a lump sum payment.

Annual Required Contribution (ARC). The ARC is the normal cost plus the portion of the unfunded actuarial accrued liability to be amortized in the current period. The ARC is an amount that is actuarially determined in accordance with the requirements so that, if paid on an ongoing basis, it would be expected to provide sufficient resources to fund both the normal cost for each year and the amortized unfunded liability.

**Governmental Accounting Standards Board (GASB).** GASB is the private, nonpartisan, nonprofit organization that works to create and improve the rules U.S. state and local governments follow when accounting for their finances and reporting them to the public.

Medical Trend Rate (Health Care Inflation). The increase in the cost of providing health care benefits over time. Trend includes such elements as pure price inflation, changes in utilization, advances in medical technology, and cost shifting.

**Normal Cost.** The annual cost assigned, under the actuarial funding method, to current and subsequent plan years. Sometimes referred to as "current service cost." Any payment toward the unfunded actuarial accrued liability is not part of the normal cost.

Other Post-Employment Employee Benefits (OPEB). OPEB are post-employment benefits other than pensions. OPEB generally takes the form of health insurance and dental, vision, prescription drugs or other healthcare benefits.

**Reserve Account.** An account used to indicate that funds have been set aside for a specific purpose and are not generally available for other uses.

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

Valuation Assets. The value of current plan assets recognized for valuation purposes.

# APPENDIX B OPEB FUNDING APPROVAL LETTER

.



Department of Retirement Services

FEDERATED CITY-EMPLOYEES' RETIREMENT SYSTEM POLICE AND FIRE DEPARTMENT RETIREMENT PLAN

#### <u>VIA EMAIL</u>

January 20, 2009

Linda Hurley Macías, Gini & O'Connell 2175 N. California Blvd, Suite 645 Walnut Creek, CA 94596

RE: Basis for the Health & Dental Benefits Valuation as of June 30, 2007

Dear Linda:

As discussed in our Wednesday, January 14, 2009 meeting, I have instructed the actuaries of the Federated City Employees Retirement System and the Police and Fire Department Retirement Plan to provide a June 30, 2007 GASB valuation of the health and dental benefits that comply with GASB statements 43 and 45 and reflects the City's cost sharing arrangement as stipulated in the municipal code, namely 50%/50% sharing of medical benefits cost and 8/3 sharing of dental benefits cost; where cost is the GASB 43/45 cost level and not the cost as defined in the prior funding methodology.

Sincerely,

Carmen Racy-Choy Deputy Director, CIO

CRC:cj

cc: Russell Crosby, City of San Jose
Andy Yeung, Segal Company
Paul Angelo, Segal Company
Leslie Thompson, Gabriel Roeder Smith & Co.
Veronica Niebla, City of San Jose
Alex Gurza, City of San Jose

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