GRS Gabriel Roeder Smith & Company
Consultants & Actuaries

CITY OF SAN JOSE FEDERATED RETIREE HEALTH CARE PLAN

ACTUARIAL VALUATION REPORT

AS OF JUNE 30, 2007

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GRS

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January 26, 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,

Leslie L. Thompson

Susan M. Hogarth

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

Susan Hogarth, EA, MAAA
Consultant

EXECUTIVE SUMMARY

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 Payroll**	**6/30/2006** (5.60%)	**As a % of Payroll**
Payroll	$271,832,564		$275,558,882	
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	$19,571,813	7.2%	$8,318,074	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	$11,296,905	$291,090
Total Employee Contribution	$19,571,813	$18,239,111	$1,332,702
Total City Contribution	$21,792,982	$18,239,111	$3,553,871

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%.

SECTION A
OVERVIEW

OPEB SPECIFIC ASSUMPTIONS

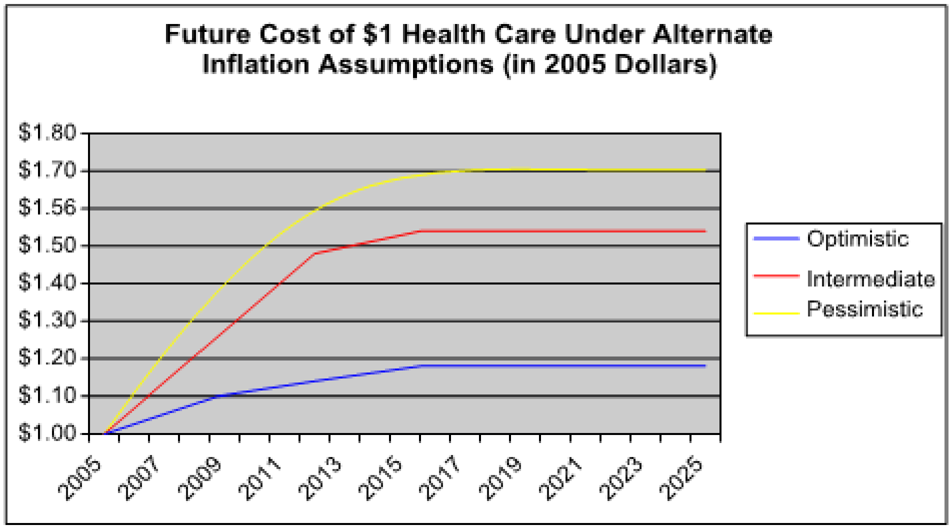
In any long-term actuarial valuation (such as for pensions and OPEB) certain demographic, economic and behavioral assumptions must be made concerning the population, investment discount rates, and the benefits provided. These actuarial assumptions form the basis for the actuarial model which is used 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.

OPEB SPECIFIC ASSUMPTIONS (CONCLUDED)



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.

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	
	2007	**2006**
Total Normal Cost	$16,818,925	$21,015,906
Less Employee Contribution towards Normal Cost	$7,910,760	$8,318,074
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*	$11,661,053	$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		**13.98%**
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*	(4.20%)	
Other miscellaneous factors	(0.35%)	
Total Change in Contribution Rate		**(5.90%)**
June 30, 2007 OPEB Employer Contribution Rate		**8.08%**

*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	**2006**
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	$425,067,347	$525,886,790
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 (A.-B.)	$616,748,714	$702,938,665
D. Actuarial Value of Assets	$96,601,000	$81,288,000
E. Unfunded Actuarial Accrued Liability (C.-D.)	$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 re-compute 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%.

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 actual valuation for the Plan and these contributions are based on a method wholly different than that prescribed under GASB.

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

Dental Premium: 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

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

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

		Post-Employement 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**

Statement of Changes in Plan Net Assets
For the Fiscal Year Ended June 30, 2007
($ in 000's)

		Post-Employement Healthcare
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 FOR BENEFITS		
Beginning of Year	**$**	**81,288**
End of Year	**$**	**96,601**

SECTION E
SUMMARY OF BENEFITS

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

A. <u>Eligibility</u>

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.

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. Retiree Premium Rates: Monthly rates used for 2007 are shown below.

	Effective January 1, 2007			
MEDICAL	Single	Increase from 2006	Family	Increase from 2006
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%
DENTAL				
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

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

Attained Age	Years of Service to Valuation Date							Total
	0-4	5-9	10-14	15-19	20-24	25-29	30 Plus	
Under 20	1							1
20-24	41	2						43
25-29	133	113	3					249
30-34	127	231	30					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

Medical

Attained Age	Number of Retirees		
	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**

Dental

Attained Age	Number of Retirees		
	Male	Female	Total
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 Age	Number of Deferred Vested		
	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 Ages	Probability of Dying Next Year		Future Life Expectancy (years)	
	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 Ages	Probability of Dying Next Year	
	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	8.74	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 Ages	Probability of Ordinary Death Next Year	
	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 Ages	Rates of 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 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

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

ACTUARIAL ASSUMPTIONS FOR SAN JOSE FEDERATED AS OF JUNE 30, 2007 (CONTINUED)

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

Year	Pre and Post Commencement Health Care Trend Inflation Rates	
	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

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

GLOSSARY

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

CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Department of Retirement Services

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

VIA EMAIL

January 20, 2009

Linda Hurley
Macias, 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