

Date: _____ January 7, 2008

Committee Meeting Date: _____ January 17, 2008

Board Meeting Date: _____ N/A

BOARD MEMORANDUM

INFORMATION ITEM

TO: Administration and Finance Committee
Santa Clara Valley Transportation Authority
Board of Directors

THROUGH: Michael T. Burns
General Manager

FROM: Jerry G. Mikolajczyk
Chief Financial Officer

SUBJECT: Actuarial Valuation of VTA's Retiree Health Plan as of July 1, 2007

FOR INFORMATION ONLY

BACKGROUND:

VTA provides retiree health care as a post employment benefit to its employees as provided for in the collective bargaining agreements and the resolution of benefits for non represented employees. VTA has been performing actuarial valuations of this obligation every two years since 1996 to determine the financial condition and contribution requirements of the Plan. VTA has been pre-funding its share of retiree health benefits and has accumulated \$101.7 million in assets as of June 30, 2007. The Governmental Accounting Standards Board (GASB) has issued Statement No. 45 which describes that these assets must be held in a qualifying trust as defined by GASB 43/45. VTA must adopt GASB 45 in FY 2008.

Milliman Consultants and Actuaries, a firm specializing in actuarial services, has prepared the actuarial valuation report of VTA's Retiree Medical Plan as of July 1, 2007. The plan's unfunded actuarial accrued liability (UAAL) is \$107 million under the current method and \$139.2 million under the GASB 45 method. The Plan's funded ratio is 49% under the current method and 42% under the GASB 45 method as compared to 40% as of July 1, 2006, under current method. A copy of the management summary and Appendix D - Valuation Results Under GASB 45, are attached for your reference.

DISCUSSION:

Milliman Consultants and Actuaries has recommended that the plan's demographic assumptions for ATU represented employees be updated to reflect the experience study performed by the ATU Pension Plan's actuary which has been implemented and is reflected in the valuation. They have also computed VTA's Annual Required Contribution (ARC) under GASB 45 which allows the

unfunded actuarial accrued liability (UAAL) to be amortized up to 30 years. VTA plans to amortize the UAAL over 20 years to be consistent with the amortization period adopted by the VTA ATU Pension Plan. This will require VTA to contribute \$15.4 million in FY2008 which is provided for in the approved FY08 budget. This amounts to 10.24% of Payroll as compared to 10.6% for FY 2007.

Adoption of GASB 45 will also require VTA to set up a qualifying trust under GASB 43/45 and transfer these assets to the trust. This will be implemented under a separate Board action in FY2008.

Prepared by: Ali Hudda, Fiscal Resources Manager, Disbursements & Revenue Services

Attachment A: Management Summary

Attachment A-1: Appendix D



Section I. Management Summary

Introduction

Milliman, Inc. has been retained by Santa Clara Valley Transportation Authority (“VTA”) to provide retiree medical actuarial valuation of its retiree health benefit plan. In our analysis we:

- Project expected payouts for the next 5 years.
- Calculate the present value of benefits and the actuarial liability, and compare these with the value of assets set aside to fund these benefits.
- Calculate the funding contribution for the upcoming fiscal year.

Highlights

Employees who retire directly from the VTA are eligible for retiree health benefits if they meet certain requirements relating to age and service. ATU Retirees can select either the Kaiser or PacifiCare retiree health plans. Certain ATU retirees are grandfathered in other plans. VTA pays the full cost of the employee-only premium, and ATU retirees who are eligible for Medicare are reimbursed for the Medicare Part B premium. ATU employees who retire on or after September 1, 2004, must contribute \$25 toward the employee only monthly premium. Results in this report are net of the \$25 premium ATU retirees will pay.

Administrative retirees eligible for Medicare can select one of the retiree health plans coordinated with Medicare. Administrative retirees not eligible for Medicare can choose among the health plans offered to active employees. VTA’s contribution towards retiree health benefits for administrative retirees is limited to the Kaiser rate for active single employees. VTA will also reimburse Medicare Part B premiums for administrative retirees eligible for Medicare. Administrative employees who retire on or after January 1, 2006, must contribute \$25 toward the employee only monthly premium. Results in this report are net of the \$25 premium Administrative retirees will pay.

VTA also provides life insurance benefits for all ATU retirees and Executive Management retirees. ATU retirees receive \$5,000 in life insurance coverage. Executive Management retirees receive \$50,000 in life insurance coverage for the first year of retirement, decreasing \$10,000 each year until its expiration in the sixth year.

VTA has begun prefunding for its share of retiree health benefits and has accumulated \$101,738,000 in plan assets as of June 30, 2007. The Plan’s actuarial liability is \$209 million as of July 1, 2007, an increase of \$8 million from the \$201 million actuarial liability as of July 1, 2006. This increase is attributed the following factors:

- Life insurance coverage for ATU retirees and Executive Management retirees, was not included in prior valuations. The inclusion of this benefit in this valuation resulted in an increase in liability of approximately \$2 million.



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- The plan's demographic assumptions for ATU employees were updated to reflect the latest experience study performed by ATU's pension actuary. This resulted in a decrease in liability of approximately \$2 million.
- Other factors such as the cost of benefit accruals since the last valuation, and the changes in VTA's demographic composition also contributed to the change in Accrual Liability. These factors resulted in an increase in liability of approximately \$8 million.
- In Exhibit 7, we show the value of the implicit medical premium subsidy for early retirees in accordance with GASB 45. Although we have not included the value of this subsidy in our calculation of current year funding contributions, we note that the inclusion of the implicit rate subsidy would increase the Actuarial Accrued Liability by approximately \$32 million.

The assets set aside to fund VTA's retiree medical benefits increased from \$79 million to \$102 million. VTA contributed \$16 million to the fund and paid \$6 million in benefits during the year. The fund earned approximately 14.3% during the year compared to an expected return of 7%. The Plan's Unfunded Liability decreased by approximately \$14 million since the last valuation, of which approximately \$6 million of the decrease is attributed to the better than expected return on assets.

Results of Study

The valuation results are summarized in the following exhibit and use the following terms:

The **Present Value of Benefits** is the present value of projected benefits (projected claims less retiree contributions) discounted at the valuation interest rate (7.0%).

The **Actuarial Accrued Liability (AAL)** is the present value of benefits that are attributed to past service only. The portion attributed to future employee service is excluded. For retirees, this is equal to the present value of benefits. For active employees, this is equal to the present value of benefits prorated by service to date over service at the full eligibility age.

The **Unfunded Actuarial Accrued Liability (UAAL)** is the AAL less the amount of assets set aside to provide for future benefits.

The **Normal Cost** is that portion of the VTA provided benefit attributable to employee service in the current year. Employees who are not eligible for benefits are assumed to have an equal portion of the present value of benefits attributed to each year of service from date of hire to full eligibility age.

The **Annual Funding Contribution** is equal to the Normal Cost plus an amount to amortize the UAAL as a level percentage of expected payroll over a fixed period of 20 years from July 1, 2001. There are 14 years remaining as of July 1, 2007.



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The valuation results are summarized below and are compared with the previous valuation.

	<u>July 1, 2007</u>	<u>July 1, 2006</u>
ATU		
Active employees	1,404	1,406
Retirees	<u>804</u>	<u>770</u>
Subtotal	2,208	2,176
Administrative		
Active employees	638	675
Retirees	<u>204</u>	<u>193</u>
Subtotal	842	868
County retirees funded by VTA	86	94
Total Participants		
Active employees	2,042	2,081
Retirees	<u>1,094</u>	<u>1,057</u>
Subtotal	<u>3,136</u>	<u>3,138</u>

	<u>July 1, 2007</u>	<u>July 1, 2006</u>
Present Value of Benefits	\$ 247,842,029	\$ 241,336,531
Actuarial Accrued Liability	\$ 208,774,591	\$ 200,636,772
Assets	<u>101,738,375</u>	<u>79,284,606</u>
Unfunded Actuarial Accrued Liability (UAAL)	\$ 107,036,216	\$ 121,352,166
Normal Cost at end of year	\$ 5,540,747	\$ 5,846,675
Amortization of UAAL at end of year	<u>9,221,391</u>	<u>9,845,981</u>
Funding Contribution	\$ 14,762,138	\$ 15,692,656
Expected Payroll	\$ 150,675,000 *	\$ 147,835,391
Contributions as a percentage of Payroll	9.80%	10.61%

* Based on a payroll of \$147 million reported by VTA increased by 2.5%.



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Assumptions

With any valuation of future benefits, assumptions of anticipated future events are required. If actual events differ from the assumptions made, the actual cost of the plan will vary as well. The following assumptions should be reviewed for appropriateness.

Discount Rate. To discount future benefit payments back to the present, we have used an interest rate of 7.0%. This rate was selected to reflect the expected rate of return on a diversified equity and bond portfolio set aside for the Retiree Health Plan. VTA reported that its current assets for its retiree medical investment portfolio are 60% in stocks, 38% in bonds and 2% in cash equivalents. This discount rate is appropriate assuming VTA continues to fund the ARC each year.

Health Cost Trend. VTA's health costs are determined for each calendar year. The actual costs for 2007 are reflected in this valuation. For future years, we have assumed health costs will increase 10% from 2007 to 2008, then grade down by 1.0% for the next 5 years, to an ultimate rate of 5.0% each year thereafter.

Demographic Rates. For administrative employees we are using the same rates used by the California Public Employees Retirement System (PERS) in its actuarial valuation of retirement benefits. For ATU employees we are using the rates developed by ATU's pension actuary in its latest study of actuarial experience from 2002 through 2006.

A complete summary of the actuarial assumptions and methods is presented in Appendix B.

Actuarial Cost Method

An actuarial cost method is used to allocate the cost of retiree health benefits for each year of employment service. Since a significant portion of benefits have already accrued for prior service for both current retirees and actives, a cost method also defines how unrecognized retiree health benefit costs attributed to prior service (i.e., Unfunded Actuarial Liability) will be amortized. Actuarial cost methods also define how changes in unfunded actuarial liability due to experience gains or losses, changes in actuarial assumptions, or changes in benefit plan design affecting liability attributed to past service are recognized in current and future years' retiree health benefit expenses.

The Projected Unit Credit (PUC) cost method is used to allocate retiree health benefit costs. This method establishes a "normal cost" (the cost allocated to the current year of service for actives) pattern for each participant that increase with age. The PUC normal costs for each individual generally increase each year at a rate slightly higher than the discount rate. The aggregate change in PUC normal costs for the active population depends on whether the employee population as a whole matures or remains fairly constant. For a constant population, the aggregate PUC normal cost would be expected to increase by the medical trend. The Unfunded Actuarial Liability (or liability attributed to past service) is amortized over a specified period. The amortization method may be level dollar or a level percentage of expected payroll increases (i.e., amortization amounts increase each year in proportion to expected payroll increases), and for each valuation, the amortization period may decline or be reset to the initial period. VTA's funding policy is currently based on the Projected Unit Credit



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cost method, and the Unfunded Actuarial Accrued Liability is being amortized as a level percentage of payroll on a fixed 20 year amortization schedule since July 1, 2001 (14 years remaining as of July 1, 2007).

Note that the value of projected benefits is the same regardless of the cost method used. Cost methods only allocate the costs by year differently. Therefore, a cost method that produces higher annual costs in early years relative to other methods would eventually produce lower annual costs in future years relative to other methods for the same benefit program.



SECTION III. APPENDICES

Appendix D. Valuation Results Under GASB 45

The following is a comparative summary of valuation results based on the current funding methodology (not compliant with GASB 45), and on methodology that is compliant with GASB 45 financial reporting requirements. The differences between the two methodologies are as follows:

- 1) GASB 45 liabilities include value of implicit rate subsidy.
- 2) GASB 45 costs are determined without regard to plan's assets unless the assets are held in a qualifying trust, defined under GASB 43/45 as an irrevocable trust that is not subject to claims from creditors, and assets may only be used to pay for retiree healthcare benefits. VTA intends to establish such a trust to hold assets set aside for retiree health benefits.
- 3) The amortization of the UAAL under GASB 45 is based on 14, 20, and 30 year amortization periods (10-30 year periods are permitted).

VTA must adopt GASB 45 beginning with the 2007-2008 fiscal year.

	<i>Current Method</i>	<i>GASB 45 Method</i>		
		<i>14 Year Amortization</i>	<i>20 Year Amortization</i>	<i>30 Year Amortization</i>
Actuarial Accrued Liability	\$208,774,591	\$240,889,022	\$240,889,022	\$240,889,022
Assets	<u>101,738,375</u>	<u>101,738,375</u>	<u>101,738,375</u>	<u>101,738,375</u>
Unf. Actuarial Accrued Liability (UAAL)	\$107,036,216	\$139,150,647	\$139,150,647	\$139,150,647
Normal Cost				
ATU	\$ 3,761,279	\$ 4,482,222	\$ 4,482,222	\$ 4,482,222
Administrative	1,416,989	1,664,660	1,664,660	1,664,660
Interest to end of Year	<u>362,479</u>	<u>430,282</u>	<u>430,282</u>	<u>430,282</u>
Total	\$ 5,540,747	\$ 6,577,164	\$ 6,577,164	\$ 6,577,164
Amortization of UAAL				
UAAL	\$107,036,216	\$139,150,647	\$139,150,647	\$139,150,647
Remaining Amortization Period	14 years	14 years	20 years	30 years
Level % of Payroll Amortization Factor	12.4199	12.4199	16.8171	23.1248
Amortization Amount – Beg of Year	8,618,122	11,203,846	8,274,354	6,017,377
Interest to end of year	<u>603,269</u>	<u>784,269</u>	<u>579,205</u>	<u>421,216</u>
Amortization Amount – End of Year	\$ 9,221,391	\$ 11,988,115	\$ 8,853,559	\$ 6,438,593
Funding Contribution / Annual Required Contribution (ARC)	\$ 14,762,138	\$ 18,565,279	\$ 15,430,723	\$ 13,015,757
Projected payroll	\$150,675,000	\$150,675,000	\$150,675,000	\$150,675,000
Contribution as % of payroll	9.80%	12.32%	10.24%	8.64%

The discount rate used to value the GASB 45 liabilities shown above is 7%, the same discount that is used under the current method. The discount rate used to determine GASB 45 liabilities is dependent on whether assets are set aside to pay for benefits, and whether VTA funds an amount at least equal to the ARC each year. Since the discount rate and other actuarial assumptions used in the valuation are subject to review and approval by VTA's auditor, the actual GASB 45 liabilities may be significantly different than the amounts stated above.