

**Aptos - La Selva Fire Protection District  
Actuarial Study of  
Retiree Health Liabilities  
As of July 1, 2015**

*Prepared by:  
Total Compensation Systems, Inc.*

*Date: February 11, 2016*

**Table of Contents**

**PART I: EXECUTIVE SUMMARY ..... 1**

A. INTRODUCTION..... 1

B. GENERAL FINDINGS..... 2

C. DESCRIPTION OF RETIREE BENEFITS ..... 2

D. RECOMMENDATIONS..... 3

**PART II: BACKGROUND..... 5**

A. SUMMARY ..... 5

B. ACTUARIAL ACCRUAL..... 5

**PART III: LIABILITIES AND COSTS FOR RETIREE BENEFITS ..... 7**

A. INTRODUCTION..... 7

B. MEDICARE..... 7

C. LIABILITY FOR RETIREE BENEFITS..... 7

D. COST TO PREFUND RETIREE BENEFITS ..... 8

*1. Normal Cost*..... 8

*2. Amortization of Unfunded Actuarial Accrued Liability (UAAL)*..... 9

*3. Annual Required Contributions (ARC)*..... 9

*4. Other Components of Annual OPEB Cost (AOC)*..... 10

**PART IV: "PAY AS YOU GO" FUNDING OF RETIREE BENEFITS ..... 11**

**PART V: RECOMMENDATIONS FOR FUTURE VALUATIONS ..... 12**

**PART VI: APPENDICES ..... 13**

APPENDIX A: MATERIALS USED FOR THIS STUDY..... 13

APPENDIX B: EFFECT OF ASSUMPTIONS USED IN CALCULATIONS ..... 14

APPENDIX C: ACTUARIAL ASSUMPTIONS AND METHODS..... 15

APPENDIX D: DISTRIBUTION OF ELIGIBLE PARTICIPANTS BY AGE ..... 20

APPENDIX E: CALCULATION OF GASB 43/45 ACCOUNTING ENTRIES..... 21

APPENDIX F: GLOSSARY OF RETIREE HEALTH VALUATION TERMS..... 23

**Aptos - La Selva Fire Protection District  
Actuarial Study of Retiree Health Liabilities**

**PART I: EXECUTIVE SUMMARY**

**A. Introduction**

Aptos - La Selva Fire Protection District engaged Total Compensation Systems, Inc. (TCS) to analyze liabilities associated with its current retiree health program as of July 1, 2015 (the valuation date). The numbers in this report are based on the assumption that they will first be used to determine accounting entries for the fiscal year ending June 30, 2016. If the report will first be used for a different fiscal year, the numbers will need to be adjusted accordingly.

This report does not reflect any cash benefits paid unless the retiree is required to provide proof that the cash benefits are used to reimburse the retiree's cost of health benefits. Costs and liabilities attributable to cash benefits paid to retirees are reportable under Governmental Accounting Standards Board (GASB) Standards 25/27.

This actuarial study is intended to serve the following purposes:

- To provide information to enable Aptos - La Selva Fire Protection District to manage the costs and liabilities associated with its retiree health benefits.
- To provide information to enable Aptos - La Selva Fire Protection District to communicate the financial implications of retiree health benefits to internal financial staff, the Board, employee groups and other affected parties.
- To provide information needed to comply with Governmental Accounting Standards Board Accounting Standards 43 and 45 related to "other postemployment benefits" (OPEB's).

Because this report was prepared in compliance with GASB 43 and 45, as appropriate, Aptos - La Selva Fire Protection District should not use this report for any other purpose without discussion with TCS. This means that any discussions with employee groups, governing Boards, etc. should be restricted to the implications of GASB 43 and 45 compliance.

This actuarial report includes several estimates for Aptos - La Selva Fire Protection District's retiree health program. In addition to the tables included in this report, we also performed cash flow adequacy tests as required under Actuarial Standard of Practice 6 (ASOP 6). Our cash flow adequacy testing covers a twenty-year period. We would be happy to make this cash flow adequacy test available to Aptos - La Selva Fire Protection District in spreadsheet format upon request.

We calculated the following estimates separately for active employees and retirees. As requested, we also separated results by the following employee classifications: Fire Fighters and All Non-Represented Employees. We estimated the following:

- the total liability created. (The actuarial present value of total projected benefits or APVTPB)
- the ten year "pay-as-you-go" cost to provide these benefits.

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- the "actuarial accrued liability (AAL)." (The AAL is the portion of the APVTPB attributable to employees' service prior to the valuation date.)
- the amount necessary to amortize the UAAL over a period of 20 years.
- the annual contribution required to fund retiree benefits over the working lifetime of eligible employees (the "normal cost").
- The Annual Required Contribution (ARC) which is the basis of calculating the annual OPEB cost and net OPEB obligation under GASB 43 and 45.

We summarized the data used to perform this study in Appendix A. No effort was made to verify this information beyond brief tests for reasonableness and consistency.

All cost and liability figures contained in this study are estimates of future results. Future results can vary dramatically and the accuracy of estimates contained in this report depends on the actuarial assumptions used. Normal costs and liabilities could easily vary by 10 - 20% or more from estimates contained in this report.

### **B. General Findings**

We estimate the "pay-as-you-go" cost of providing retiree health benefits in the year beginning July 1, 2015 to be \$88,047 (see Section IV.A.). The "pay-as-you-go" cost is the cost of benefits for current retirees.

For current employees, the value of benefits "accrued" in the year beginning July 1, 2015 (the normal cost) is \$21,722. This normal cost would increase each year based on covered payroll. Had Aptos - La Selva Fire Protection District begun accruing retiree health benefits when each current employee and retiree was hired, a sizeable liability would have accumulated. We estimate the amount that would have accumulated to be \$1,432,092. This amount is called the "actuarial accrued liability" (AAL). The remaining unamortized balance of the initial unfunded AAL (UAAL) is \$1,045,427. This leaves a "residual" AAL of \$386,665.

Aptos - La Selva Fire Protection District has established a GASB 43 trust for future OPEB benefits. The actuarial value of plan assets at June 30, 2015 was \$627,166. This leaves a residual unfunded actuarial accrued liability (UAAL) of *negative* \$240,501. We calculated the annual cost to amortize the residual unfunded actuarial accrued liability using a 7% discount rate. We used an open 20 year amortization period. The current year cost to amortize the residual unfunded actuarial accrued liability is *negative* \$17,911.

Combining the normal cost with both the initial and residual UAAL amortization costs produces an annual required contribution (ARC) of \$79,114. The ARC is used as the basis for determining expenses and liabilities under GASB 43/45. The ARC is used in lieu of (rather than in addition to) the "pay-as-you-go" cost.

We based all of the above estimates on employees as of June, 2015. Over time, liabilities and cash flow will vary based on the number and demographic characteristics of employees and retirees.

### **C. Description of Retiree Benefits**

Following is a description of the current retiree benefit plan. The following benefits are provided in addition to statutory minimum benefits under Government Code Section 22892. The benefits below apply ONLY to those hired prior to April 1, 2005. Employees hired on or after April 1, 2005 are eligible for a "Defined Contribution" plan which does not involve any post-retirement employer contributions. Consequently, retiree benefits valued in this

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report for employees hired on or after April 1, 2005 are limited to the statutory minimum employer contributions.

Benefit types provided	<u>Safety</u>	<u>Miscellaneous and Safety</u>
	Health Reimbursement Account	<u>Management</u> Health Reimbursement Account
Duration of Benefits	To 65	To 65
Required Service	15 years with District	15 years with District
Minimum Age	Retirement under CalPERS	Retirement under CalPERS
Dependent Coverage	No	No
District Contribution %	100%*	100%*
District Cap	\$350 per month*	\$350 per month*

\*This relates to the payment of the retirement benefit. Employer contributions to the RHS during the employees working career are NOT reflected in this report.

### D. Recommendations

It is outside the scope of this report to make specific recommendations of actions Aptos - La Selva Fire Protection District should take to manage the sizeable liability created by the current retiree health program. Total Compensation Systems, Inc. can assist in identifying and evaluating options once this report has been studied. The following recommendations are intended only to allow the District to get more information from this and future studies. Because we have not conducted a comprehensive administrative audit of Aptos - La Selva Fire Protection District's practices, it is possible that Aptos - La Selva Fire Protection District is already complying with some or all of our recommendations.

- We recommend that Aptos - La Selva Fire Protection District inventory all benefits and services provided to retirees – whether contractually or not and whether retiree-paid or not. For each, Aptos - La Selva Fire Protection District should determine whether the benefit is material and subject to GASB 43 and/or 45.
- We recommend that Aptos - La Selva Fire Protection District conduct a study whenever events or contemplated actions significantly affect present or future liabilities, but no less frequently than every two years, as required under GASB 43/45.
- We recommend that the District communicate the magnitude of these costs to employees and include employees in discussions of options to control the costs.
- Under GASB 45, it is important to isolate the cost of retiree health benefits. Aptos - La Selva Fire Protection District should continue to have all premiums, claims and expenses for retirees separated from active employee premiums, claims, expenses, etc. To the extent any retiree benefits are made available to retirees over the age of 65 – *even on a retiree-pay-all basis* – all premiums, claims and expenses for post-65 retiree coverage should continue to be segregated from those for pre-65 coverage.
- Aptos - La Selva Fire Protection District should establish a way of designating employees as eligible or ineligible for future OPEB benefits. Ineligible employees can include those in ineligible job classes; those hired after a designated date restricting eligibility; those who, due to their age at

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hire cannot qualify for District-paid OPEB benefits; employees who exceed the termination age for OPEB benefits, etc.

- Several assumptions were made in estimating costs and liabilities under Aptos - La Selva Fire Protection District's retiree health program. Further studies may be desired to validate any assumptions where there is any doubt that the assumption is appropriate. (See Appendices B and C for a list of assumptions and concerns.) For example, Aptos - La Selva Fire Protection District should maintain a retiree database that includes – in addition to date of birth, gender and employee classification – retirement date and (if applicable) dependent date of birth, relationship and gender. It will also be helpful for Aptos - La Selva Fire Protection District to maintain employment termination information – namely, the number of OPEB-eligible employees in each employee class that terminate employment each year for reasons other than death, disability or retirement.

Respectfully submitted,



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## PART II: BACKGROUND

### A. Summary

Accounting principles provide that the cost of retiree benefits should be “accrued” over employees' working lifetime. For this reason, the Governmental Accounting Standards Board (GASB) issued in 2004 Accounting Standards 43 and 45 for retiree health benefits. These standards apply to all public employers that pay any part of the cost of retiree health benefits for current or future retirees (including early retirees).

### B. Actuarial Accrual

To actuarially accrue retiree health benefits requires determining the amount to expense each year so that the liability accumulated at retirement is, on average, sufficient (with interest) to cover all retiree health expenditures without the need for additional expenses. There are many different ways to determine the annual accrual amount. The calculation method used is called an “actuarial cost method.”

Under most actuarial cost methods, there are two components of actuarial cost - a “normal cost” and amortization of something called the “unfunded actuarial accrued liability.” Both accounting standards and actuarial standards usually address these two components separately (though alternative terminology is sometimes used).

The normal cost can be thought of as the value of the benefit earned each year if benefits are accrued during the working lifetime of employees. This report will not discuss differences between actuarial cost methods or their application. Instead, following is a description of a commonly used, generally accepted actuarial cost method permitted under GASB 43 and 45. This actuarial cost method is called the “entry age normal” method.

Under the entry age normal cost method, the actuary determines the annual amount needing to be expensed from hire until retirement to fully accrue the cost of retiree health benefits. This amount is the normal cost. Under GASB 43 and 45, normal cost can be expressed either as a level dollar amount or a level percentage of payroll.

The normal cost is determined using several key assumptions:

- The current *cost of retiree health benefits* (often varying by age, Medicare status and/or dependent coverage). The higher the current cost of retiree benefits, the higher the normal cost.
- The “*trend*” rate at which retiree health benefits are expected to increase over time. A higher trend rate increases the normal cost. A “cap” on District contributions can reduce trend to zero once the cap is reached thereby dramatically reducing normal costs.
- *Mortality rates* varying by age and sex. (Unisex mortality rates are not often used as individual OPEB benefits do not depend on the mortality table used.) If employees die prior to retirement, past contributions are available to fund benefits for employees who live to retirement. After retirement, death results in benefit termination or reduction. Although higher mortality rates reduce normal costs, the mortality assumption is not likely to vary from employer to employer.
- *Employment termination rates* have the same effect as mortality inasmuch as higher termination rates reduce normal costs. Employment termination can vary considerably between public agencies.
- The *service requirement* reflects years of service required to earn full or partial retiree benefits.

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While a longer service requirement reduces costs, cost reductions are not usually substantial unless the service period exceeds 20 years of service.

- **Retirement rates** determine what proportion of employees retire at each age (assuming employees reach the requisite length of service). Retirement rates often vary by employee classification and implicitly reflect the minimum retirement age required for eligibility. Retirement rates also depend on the amount of pension benefits available. Higher retirement rates increase normal costs but, except for differences in minimum retirement age, retirement rates tend to be consistent between public agencies for each employee type.
- **Participation rates** indicate what proportion of retirees are expected to elect retiree health benefits if a significant retiree contribution is required. Higher participation rates increase costs.
- The **discount rate** estimates investment earnings for assets earmarked to cover retiree health benefit liabilities. The discount rate depends on the nature of underlying assets. For example, employer funds earning money market rates in the county treasury are likely to earn far less than an irrevocable trust containing a diversified asset portfolio including stocks, bonds, etc. A higher discount rate can dramatically lower normal costs. GASB 43 and 45 require the interest assumption to reflect likely *long term* investment return.

The assumptions listed above are not exhaustive, but are the most common assumptions used in actuarial cost calculations. The actuary selects the assumptions which - taken together - will yield reasonable results. It's not necessary (or even possible) to predict individual assumptions with complete accuracy.

If all actuarial assumptions are exactly met and an employer expensed the normal cost every year for all past and current employees and retirees, a sizeable liability would have accumulated (after adding interest and subtracting retiree benefit costs). The liability that would have accumulated is called the actuarial accrued liability or AAL. The excess of AAL over the **actuarial value of plan assets** is called the *unfunded* actuarial accrued liability (or UAAL). Under GASB 43 and 45, in order for assets to count toward offsetting the AAL, the assets have to be held in an irrevocable trust that is safe from creditors and can only be used to provide OPEB benefits to eligible participants.

The actuarial accrued liability (AAL) can arise in several ways. At inception of GASB 43 and 45, there is usually a substantial UAAL. Some portion of this amount can be established as the "transition obligation" subject to certain constraints. UAAL can also increase as the result of operation of a retiree health plan - e.g., as a result of plan changes or changes in actuarial assumptions. Finally, AAL can arise from actuarial gains and losses. Actuarial gains and losses result from differences between actuarial assumptions and actual plan experience.

Under GASB 43 and 45, employers have several options on how the UAAL can be amortized as follows:

- The employer can select an amortization period of 1 to 30 years. (For certain situations that result in a reduction of the AAL, the amortization period must be at least 10 years.)
- The employer may apply the same amortization period to the total combined UAAL or can apply different periods to different components of the UAAL.
- The employer may elect a "closed" or "open" amortization period.
- The employer may choose to amortize on a level dollar or level percentage of payroll method.



## PART III: LIABILITIES AND COSTS FOR RETIREE BENEFITS

### A. Introduction.

We calculated the actuarial present value of projected benefits (APVPB) separately for each employee. We determined eligibility for retiree benefits based on information supplied by Aptos - La Selva Fire Protection District. We then selected assumptions for the factors discussed in the above Section that, based on plan experience and our training and experience, represent our best prediction of future plan experience. For each employee, we applied the appropriate factors based on the employee's age, sex and length of service.

We summarized actuarial assumptions used for this study in Appendix C.

### B. Medicare

The extent of Medicare coverage can affect projections of retiree health costs. The method of coordinating Medicare benefits with the retiree health plan's benefits can have a substantial impact on retiree health costs. We will be happy to provide more information about Medicare integration methods if requested.

### C. Liability for Retiree Benefits.

For each employee, we projected future premium costs using an assumed trend rate (see Appendix C). To the extent Aptos - La Selva Fire Protection District uses contribution caps, the influence of the trend factor is further reduced.

We multiplied each year's projected cost by the probability that premium will be paid; i.e. based on the probability that the employee is living, has not terminated employment and has retired. The probability that premium will be paid is zero if the employee is not eligible. The employee is not eligible if s/he has not met minimum service, minimum age or, if applicable, maximum age requirements.

The product of each year's premium cost and the probability that premium will be paid equals the expected cost for that year. We discounted the expected cost for each year to the valuation date July 1, 2015 at 7% interest.

Finally, we multiplied the above discounted expected cost figures by the probability that the retiree would elect coverage. A retiree may not elect to be covered if retiree health coverage is available less expensively from another source (e.g. Medicare risk contract) or the retiree is covered under a spouse's plan.

For any current retirees, the approach used was similar. The major difference is that the probability of payment for current retirees depends only on mortality and age restrictions (i.e. for retired employees the probability of being retired and of not being terminated are always both 1.0000).

We added the APVPB for all employees to get the actuarial present value of total projected benefits (APVTPB). The APVTPB is the estimated present value of all future retiree health benefits for all **current** employees and retirees. The APVTPB is the amount on July 1, 2015 that, if all actuarial assumptions are exactly right, would be sufficient to expense all promised benefits until the last current employee or retiree dies or reaches the maximum eligibility age.

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### Actuarial Present Value of Total Projected Benefits at July 1, 2015

	<i>Total</i>	<i>Fire Fighters</i>	<i>All Non-Represented Employees</i>
Active: Pre-65	\$456,947	\$373,499	\$83,448
Post-65	\$358,194	\$276,455	\$81,739
Subtotal	\$815,141	\$649,954	\$165,187
Retiree: Pre-65	\$340,083	\$235,214	\$104,869
Post-65	\$425,235	\$355,105	\$70,130
Subtotal	\$765,318	\$590,319	\$174,999
Grand Total	\$1,580,459	\$1,240,273	\$340,186
Subtotal Pre-65	\$797,030	\$608,713	\$188,317
Subtotal Post-65	\$783,429	\$631,560	\$151,869

The APVTPB should be accrued over the working lifetime of employees. At any time much of it has not been "earned" by employees. The APVTPB is used to develop expense and liability figures. To do so, the APVTFB is divided into two parts: the portions attributable to service rendered prior to the valuation date (the past service liability or actuarial accrued liability under GASB 43 and 45) and to service after the valuation date but prior to retirement (the future service liability).

The past service and future service liabilities are each funded in a different way. We will start with the future service liability which is funded by the normal cost.

#### **D. Cost to Prefund Retiree Benefits**

##### 1. Normal Cost

The average hire age for eligible employees is 32. To accrue the liability by retirement, the District would accrue the retiree liability over a period of about 24 years (assuming an average retirement age of 56). We applied an "entry age normal" actuarial cost method to determine funding rates for active employees. The table below summarizes the calculated normal cost.

#### **Normal Cost Year Beginning July 1, 2015**

	<i>Total</i>	<i>Fire Fighters</i>	<i>All Non-Represented Employees</i>
<b># of Employees</b>	38	30	8
<b>Per Capita Normal Cost</b>			
Pre-65 Benefit	N/A	\$254	\$179
Post-65 Benefit	N/A	\$341	\$305
<b>First Year Normal Cost</b>			
Pre-65 Benefit	\$9,052	\$7,620	\$1,432
Post-65 Benefit	\$12,670	\$10,230	\$2,440
Total	\$21,722	\$17,850	\$3,872

Accruing retiree health benefit costs using normal costs levels out the cost of retiree health benefits over time and more fairly reflects the value of benefits "earned" each year by employees. This normal cost would increase each year based on covered payroll.

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### 2. Amortization of Unfunded Actuarial Accrued Liability (UAAL)

If actuarial assumptions are borne out by experience, the District will fully accrue retiree benefits by expensing an amount each year that equals the normal cost. If no accruals had taken place in the past, there would be a shortfall of many years' accruals, accumulated interest and forfeitures for terminated or deceased employees. This shortfall is called the actuarial accrued liability (AAL). We calculated the AAL as the APVTPB minus the present value of future normal costs.

The initial UAAL was amortized using level percent, closed 30 year amortization. The District can amortize the remaining or residual UAAL over many years. The table below shows the annual amount necessary to amortize the UAAL over a period of 20 years at 7% interest. (Thirty years is the longest amortization period allowable under GASB 43 and 45.) GASB 43 and 45 allow amortizing the UAAL using either payments that stay the same as a dollar amount, or payments that are a flat percentage of covered payroll over time. The figures below reflect level percent, open 20 year amortization.

#### **Actuarial Accrued Liability as of July 1, 2015**

	<i>Total</i>	<i>Fire Fighters</i>	<i>All Non-Represented Employees</i>
Active: Pre-65	\$394,928	\$320,017	\$74,911
Post-65	\$271,846	\$204,654	\$67,192
Subtotal	\$666,774	\$524,671	\$142,103
Retiree: Pre-65	\$340,083	\$235,214	\$104,869
Post-65	\$425,235	\$355,105	\$70,130
Subtotal	\$765,318	\$590,319	\$174,999
Subtot Pre-65	\$735,011	\$555,231	\$179,780
Subtot Post-65	\$697,081	\$559,759	\$137,322
Grand Total	\$1,432,092	\$1,114,990	\$317,102
Unamortized Initial UAAL	\$1,045,427		
Plan assets at 6/30/15	\$627,166		
Residual UAAL	(\$240,501)		
Residual UAAL Amortization at 7% over 20 Years	(\$17,911)		

### 3. Annual Required Contributions (ARC)

If the District determines retiree health plan expenses in accordance with GASB 43 and 45, costs include both normal cost and one or more components of UAAL amortization costs. The sum of normal cost and UAAL amortization costs is called the Annual Required Contribution (ARC) and is shown below.

#### **Annual Required Contribution (ARC) Year Beginning July 1, 2015**

	<i>Total</i>
Normal Cost	\$21,722
Initial UAAL Amortization	\$75,303
Residual UAAL Amortization	(\$17,911)
ARC	\$79,114

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The normal cost remains as long as there are active employees who may some day qualify for District-paid retiree health benefits. This normal cost would increase each year based on covered payroll.

### 4. Other Components of Annual OPEB Cost (AOC)

Expense and liability amounts may include more components of cost than the normal cost plus amortization of the UAAL. This applies to employers that don't fully fund the Annual Required Contribution (ARC) through an irrevocable trust.

- The annual OPEB cost (AOC) includes assumed interest on the net OPEB obligation (NOO). The annual OPEB cost also includes an amortization adjustment for the net OPEB obligation. (It should be noted that there is no NOO if the ARC is fully funded through a qualifying "plan".)
- The net OPEB obligation equals the accumulated differences between the (AOC) and qualifying "plan" contributions.

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### PART IV: "PAY AS YOU GO" FUNDING OF RETIREE BENEFITS

We used the actuarial assumptions shown in Appendix C to project ten year cash flow under the retiree health program. Because these cash flow estimates reflect average assumptions applied to a relatively small number of employees, estimates for individual years are certain to be *in*accurate. However, these estimates show the size of cash outflow.

The following table shows a projection of annual amounts needed to pay the District share of retiree health premiums.

<i>Year Beginning July 1</i>	<i>Total</i>	<i>Fire Fighters</i>	<i>All Non- Represented Employees</i>
2015	\$88,047	\$68,499	\$19,548
2016	\$89,912	\$69,162	\$20,750
2017	\$96,796	\$73,709	\$23,087
2018	\$99,215	\$77,784	\$21,431
2019	\$105,286	\$81,795	\$23,491
2020	\$115,184	\$89,748	\$25,436
2021	\$114,261	\$90,572	\$23,689
2022	\$112,266	\$86,711	\$25,555
2023	\$101,601	\$82,400	\$19,201
2024	\$105,293	\$84,648	\$20,645

### PART V: RECOMMENDATIONS FOR FUTURE VALUATIONS

To effectively manage benefit costs, an employer must periodically examine the existing liability for retiree benefits as well as future annual expected premium costs. GASB 43/45 require biennial valuations. In addition, a valuation should be conducted whenever plan changes, changes in actuarial assumptions or other employer actions are likely to cause a material change in accrual costs and/or liabilities.

Following are examples of actions that could trigger a new valuation.

- An employer should perform a valuation whenever the employer considers or puts in place an early retirement incentive program.
- An employer should perform a valuation whenever the employer adopts a retiree benefit plan for some or all employees.
- An employer should perform a valuation whenever the employer considers or implements changes to retiree benefit provisions or eligibility requirements.
- An employer should perform a valuation whenever the employer introduces or changes retiree contributions.

We recommend Aptos - La Selva Fire Protection District take the following actions to ease future valuations.

- We have used our training, experience and information available to us to establish the actuarial assumptions used in this valuation. We have no information to indicate that any of the assumptions do not reasonably reflect future plan experience. However, the District should review the actuarial assumptions in Appendix C carefully. If the District has any reason to believe that any of these assumptions do not reasonably represent the expected future experience of the retiree health plan, the District should engage in discussions or perform analyses to determine the best estimate of the assumption in question.

**PART VI: APPENDICES**

**APPENDIX A: MATERIALS USED FOR THIS STUDY**

We relied on the following materials to complete this study.

- We used paper reports and digital files containing employee demographic data from the District personnel records.
- We used relevant sections of collective bargaining agreements provided by the District.

### **APPENDIX B: EFFECT OF ASSUMPTIONS USED IN CALCULATIONS**

While we believe the estimates in this study are reasonable overall, it was necessary for us to use assumptions which inevitably introduce errors. We believe that the errors caused by our assumptions will not materially affect study results. If the District wants more refined estimates for decision-making, we recommend additional investigation. Following is a brief summary of the impact of some of the more critical assumptions.

1. Where actuarial assumptions differ from expected experience, our estimates could be overstated or understated. One of the most critical assumptions is the medical trend rate. The District may want to commission further study to assess the sensitivity of liability estimates to our medical trend assumptions. For example, it may be helpful to know how liabilities would be affected by using a trend factor 1% higher than what was used in this study. There is an additional fee required to calculate the impact of alternative trend assumptions.
2. We used an "entry age normal" actuarial cost method to estimate the actuarial accrued liability and normal cost. GASB allows this as one of several permissible methods under GASB45. Using a different cost method could result in a somewhat different recognition pattern of costs and liabilities.



## **APPENDIX C: ACTUARIAL ASSUMPTIONS AND METHODS**

Following is a summary of actuarial assumptions and methods used in this study. The District should carefully review these assumptions and methods to make sure they reflect the District's assessment of its underlying experience. It is important for Aptos - La Selva Fire Protection District to understand that the appropriateness of all selected actuarial assumptions and methods are Aptos - La Selva Fire Protection District's responsibility. Unless otherwise disclosed in this report, TCS believes that all methods and assumptions are within a reasonable range based on the provisions of GASB 43 and 45, applicable actuarial standards of practice, Aptos - La Selva Fire Protection District's actual historical experience, and TCS's judgment based on experience and training.

### **ACTUARIAL METHODS AND ASSUMPTIONS:**

**ACTUARIAL COST METHOD:** Entry age normal. The allocation of OPEB cost is based on years of service. We used the level percentage of payroll method to allocate OPEB cost over years of service.

Entry age is based on the age at hire for eligible employees. The attribution period is determined as the difference between the expected retirement age and the age at hire. The present value of future benefits and present value of future normal costs are determined on an employee by employee basis and then aggregated.

To the extent that different benefit formulas apply to different employees of the same class, the normal cost is based on the benefit plan applicable to the most recently hired employees (including future hires if a new benefit formula has been agreed to and communicated to employees).

**AMORTIZATION METHODS:** We used a level percent, closed 30 year amortization period for the initial UAAL. We used a level percent, open 20 year amortization period for any residual UAAL.

**SUBSTANTIVE PLAN:** As required under GASB 43 and 45, we based the valuation on the substantive plan. The formulation of the substantive plan was based on a review of written plan documents as well as historical information provided by Aptos - La Selva Fire Protection District regarding practices with respect to employer and employee contributions and other relevant factors.

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### ECONOMIC ASSUMPTIONS:

Economic assumptions are set under the guidance of Actuarial Standard of Practice 27 (ASOP 27). Among other things, ASOP 27 provides that economic assumptions should reflect a consistent underlying rate of general inflation. For that reason, we show our assumed long-term inflation rate below.

INFLATION: We assumed 2.75% per year.

INVESTMENT RETURN / DISCOUNT RATE: We assumed 7% per year. This is based on assumed long-term return on plan assets assuming 100% funding through CERBT. We used the “Building Block Method” as described in ASOP 27 Paragraph 3.6.2.

TREND: We assumed 4% per year. Our long-term trend assumption is based on the conclusion that, while medical trend will continue to be cyclical, the average increase over time cannot continue to outstrip general inflation by a wide margin. Trend increases in excess of general inflation result in dramatic increases in unemployment, the number of uninsured and the number of underinsured. These effects are nearing a tipping point which will inevitably result in fundamental changes in health care finance and/or delivery which will bring increases in health care costs more closely in line with general inflation. We do not believe it is reasonable to project historical trend vs. inflation differences several decades into the future.

PAYROLL INCREASE: We assumed 2.75% per year. This assumption applies only to the extent that either or both of the normal cost and/or UAAL amortization use the level percentage of payroll method. For purposes of applying the level percentage of payroll method, payroll increase must not assume any increases in staff or merit increases.

ACTUARIAL VALUE OF PLAN ASSETS (AVA): We used asset values provided by Aptos - La Selva Fire Protection District. We used a 5 year smoothing formula with a 20% corridor around market value.

The following are the calculations for the adjusted value of plan assets:

<i>CERBT - Strategy 1</i>	<i>Amount</i>
(1) Market value at 6/30/15	\$631,918
(2) Accumulated contributions (disbursements) at 7.25%	\$625,978
(3) Value in (2) + 1/5 of (1) minus (2)	\$627,166
(4) Value in (3) adjusted to minimum or maximum*	\$627,166
(5) AVA at 6/30/15 adjusted to valuation date at 7.25%	\$627,166

\* Minimum is 80% of market value; maximum is 120% of market value

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### NON-ECONOMIC ASSUMPTIONS:

Economic assumptions are set under the guidance of Actuarial Standard of Practice 35 (ASOP 35).

### ***MORTALITY***

<b><i>Employee Type</i></b>	<b><i>Mortality Tables</i></b>
Fire Fighters	2014 CalPERS Mortality for Active Safety Employees
Miscellaneous	2014 CalPERS Active Mortality for Miscellaneous Employees

### ***RETIREMENT RATES***

<b><i>Employee Type</i></b>	<b><i>Retirement Rate Tables</i></b>
Fire Fighters	Hired < 1/1/13: 2009 CalPERS 3% @55 Rates for Sworn Fire Employees Hired > 12/31/12: 2009 CalPERS 3% @55 Rates for Sworn Fire Employees adjusted to reflect a minimum retirement age of 52
Miscellaneous	2009 CalPERS 3.0% @60 Rates for Miscellaneous Employees

### ***VESTING RATES***

<b><i>Employee Type</i></b>	<b><i>Vesting Rate Tables</i></b>
Fire Fighters	100% at 5 Years of Service for statutory minimum benefits 100% at 15 Years of Service for \$350 postretirement contribution
All Non-Represented Employees	100% at 5 Years of Service for statutory minimum benefits 100% at 15 Years of Service for \$350 postretirement contribution

### ***COSTS FOR RETIREE COVERAGE***

Actuarial Standard of Practice 6 (ASOP 6) provides that, as a general rule, retiree costs should be based on actual claim costs or age-adjusted premiums. This is true even for many medical plans that are commonly considered to be “community-rated.” However, ASOP 6 contains a provision – specifically section 3.7.7(c) – that allows use of unadjusted premiums in certain circumstances.

Because the section 3.7.7(c) exception is new, there is not a consensus among practicing actuaries regarding the specific circumstances under which a section 3.7.7(c) exception may be invoked. It is my opinion that the section 3.7.7(c)(4) exception allows use of unadjusted premium for PEMHCA agencies if certain conditions are met. Other actuaries have taken the position that ASOP 6 does not explicitly allow use of unadjusted premium for any agencies participating in the CalPERS medical plan.

Prior to the most recent ASOP 6 revision, there was general agreement that ASOP 6 allowed use of unadjusted premium as a retiree cost basis for PEMHCA agencies (under section 3.4.5 of the prior version of ASOP 6). Since there have been no changes to the CalPERS medical plan, use of unadjusted premium must still be viewed as appropriate actuarial practice to the extent that it was under the prior version of ASOP 6. That means that if the current ASOP 6 section 3.7.7(c)(4) exception is not deemed to ***explicitly*** allow use of unadjusted premium as a retiree cost basis for Aptos - La Selva Fire Protection District, then it would be allowable as a “deviation.” (Under GASB 45, there is no prohibition against using a “deviation.”)

While I am confident that ASOP 6 section 3.7.7(c)(4) will ultimately be found to explicitly allow use of unadjusted premium as a retiree cost basis for most PEMHCA agencies, I cannot be certain that this will be the case if and when this issue is fully reviewed. Therefore, I am including disclosure information required for a “deviation” so that the valuation will not need to be revised in the event section 3.7.7(c)(4) should be found not to explicitly allow use of unadjusted premium. Following is the disclosure information that is required should a deviation be necessary.

Use of ***age-adjusted*** premium for the CalPERS medical plan results in an overstatement of Aptos - La Selva Fire

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Protection District Annual Required Contribution (ARC) and Actuarial Accrued Liability (AAL) to the extent that Aptos - La Selva Fire Protection District continues to participate in the CalPERS medical plan AND that the rate structure of the CalPERS medical plan continues in its current form (i.e. with no rate distinction between active employees and retirees). In addition to the overstatement of OPEB costs and liabilities, Aptos - La Selva Fire Protection District policy of funding OPEB obligations could lead to an inability of Aptos - La Selva Fire Protection District Agency to recover overfunded assets. It is important to note that, should Aptos - La Selva Fire Protection District leave the CalPERS medical plan, the subsequent plan may not qualify to use unadjusted premium rates. In this event, leaving the CalPERS medical plan would be comparable to a significant change in plan terms and would likely require a new valuation.

Following are the criteria we applied to Aptos - La Selva Fire Protection District to determine that it is reasonable to assume that Aptos - La Selva Fire Protection District future participation in PEMHCA is likely and that the CalPERS medical program as well as its premium structure are sustainable. (We also have an extensive white paper on this subject that provides a basis for our rationale entirely within the context of ASOP 6. We will make this white paper available upon request.)

The District participates in the CalPERS medical program. We have performed the required evaluation of the CalPERS medical program and we have determined that there is sufficient evidence to apply the 3.7.7.c.4 exception. Following are details regarding the evaluation based on the criteria we have set:

- **Plan qualifies as a “pooled health plan.”** ASOP 6 defines a “pooled health plan” as one in which premiums are based at least in part on the claims experience of groups other than the one being valued.” Since CalPERS rates are the same for all employers in each region, rates are clearly based on the experience of many groups.
- **Rates not based to any extent on the agency’s claim experience.** As mentioned above, rates are the same for all participating employers regardless of claim experience or size.
- **Rates not based to any extent on the agency’s demographics.** As mentioned above, rates are the same for all participating employers regardless of demographics.
- **No refunds or charges based on the agency’s claim experience or demographics.** The terms of operation of the CalPERS program are set by statute and there is no provision for any refunds and charges that vary from employer to employer for any reason. The only charges are uniform administrative charges.
- **Plan in existence 20 or more years.** Enabling legislation to allow “contracting agencies” to participate in the CalPERS program was passed in 1967. The CalPERS medical plan has been successfully operating for almost 50 years. As far back as we can obtain records, the rating structure has been consistent, with the only difference having been a move to regional rating which is unrelated to age-adjusted rating.
- **No recent large increases or decreases in the number of participating plans or enrollment.** The CalPERS medical plan has shown remarkably stable enrollment. In the past 10 years, there has been small growth in the number of employers in most years – with the maximum being a little over 2% and a very small decrease in one year. Average year over year growth in the number of employers over the last 10 years has been about 0.75% per year. Groups have been consistently

## Total Compensation Systems, Inc.

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leaving the CalPERS medical plan while other groups have been joining with no disruption to its stability.

- **Agency is not expecting to leave plan in foreseeable future.** The District does not plan to leave CalPERS at present.
- **No indication the plan will be discontinued.** We are unaware of anything that would cause the CalPERS medical plan to cease or to significantly change its operation in a way that would affect this determination.
- **The agency does not represent a large part of the pool.** The District is in the CalPERS “Bay Area” region. Based on the information we have, the District constitutes no more than 0.06% of the Bay Area pool. In our opinion, this is not enough for the District to have a measurable effect on the rates or viability of the Bay Area pool.

Retiree liabilities are based on actual retiree costs. Liabilities for active participants are based on the first year costs shown below. Subsequent years’ costs are based on first year costs adjusted for trend and limited by any District contribution caps.

<i>Employee Type</i>	<i>Future Retirees Pre-65</i>	<i>Future Retirees Post-65</i>
All Non-Represented Employees	\$1,464 for statutory minimum benefits \$4,200 for postretirement contribution	\$1,464 for statutory minimum benefits
Fire Fighters	\$1,464 for statutory minimum benefits \$4,200 for postretirement contribution	\$1,464 for statutory minimum benefits

### ***PARTICIPATION RATES***

<i>Employee Type</i>	<i>&lt;65 Non-Medicare Participation %</i>	<i>65+ Medicare Participation %</i>
Fire Fighters	90% for statutory minimum benefits 100% for postretirement contribution	90% for statutory minimum benefits
All Non-Represented Employees	90% for statutory minimum benefits 100% for postretirement contribution	90% for statutory minimum benefits

### ***TURNOVER***

<i>Employee Type</i>	<i>Turnover Rate Tables</i>
Fire Fighters	2009 CalPERS Rates for Sworn Fire Employees
Miscellaneous	2009 CalPERS Turnover for Miscellaneous Employees

### ***SPOUSE PREVALENCE***

To the extent not provided and when needed to calculate benefit liabilities, 80% of retirees assumed to be married at retirement. After retirement, the percentage married is adjusted to reflect mortality.

### ***SPOUSE AGES***

To the extent spouse dates of birth are not provided and when needed to calculate benefit liabilities, female spouse assumed to be three years younger than male.

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### APPENDIX D: DISTRIBUTION OF ELIGIBLE PARTICIPANTS BY AGE

#### **ELIGIBLE ACTIVE EMPLOYEES**

<i>Age</i>	<i>Total</i>	<i>Fire Fighters</i>	<i>All Non-Represented Employees</i>
Under 25	0	0	0
25-29	1	1	0
30-34	2	2	0
35-39	9	8	1
40-44	5	4	1
45-49	8	6	2
50-54	3	3	0
55-59	9	5	4
60-64	0	0	0
65 and older	1	1	0
Total	38	30	8

#### **ELIGIBLE RETIREES**

<i>Age</i>	<i>Total</i>	<i>Fire Fighters</i>	<i>All Non-Represented Employees</i>
Under 50	0	0	0
50-54	2	1	1
55-59	7	5	2
60-64	6	5	1
65-69	6	6	0
70-74	1	1	0
75-79	1	1	0
80-84	1	1	0
85-89	0	0	0
90 and older	0	0	0
Total	24	20	4

### APPENDIX E: CALCULATION OF GASB 43/45 ACCOUNTING ENTRIES

This report is to be used to calculate accounting entries rather than to provide the dollar amount of accounting entries. How the report is to be used to calculate accounting entries depends on several factors. Among them are:

- 1) The amount of prior accounting entries;
- 2) Whether individual components of the ARC are calculated as a level dollar amount or as a level percentage of payroll;
- 3) Whether the employer using a level percentage of payroll method elects to use for this purpose projected payroll, budgeted payroll or actual payroll;
- 4) Whether the employer chooses to adjust the numbers in the report to reflect the difference between the valuation date and the first fiscal year for which the numbers will be used.

To the extent the level percentage of payroll method is used, the employer should adjust the numbers in this report as appropriate to reflect the change in OPEB covered payroll. It should be noted that OPEB covered payroll should only reflect types of pay generating pension credits for plan participants. Please note that plan participants do not necessarily include all active employees eligible for health benefits for several reasons. Following are examples.

- 1) The number of hours worked or other eligibility criteria may differ for OPEB compared to active health benefits;
- 2) There may be active employees over the maximum age OPEB are paid through. For example, if an OPEB plan pays benefits only to Medicare age, any active employees currently over Medicare age are not plan participants;
- 3) Employees hired at an age where they will exceed the maximum age for benefits when the service requirement is met are also not plan participants.

Finally, GASB 43 and 45 require reporting covered payroll in RSI schedules regardless of whether any ARC component is based on the level percentage of payroll method. This report does not provide, nor should the actuary be relied on to report covered payroll.

GASB 45 Paragraph 26 specifies that the items presented as RSI "should be calculated in accordance with the parameters." The RSI items refer to Paragraph 25.c which includes annual covered payroll. Footnote 3 provides that when the ARC is based on covered payroll, the payroll measure may be the projected payroll, budgeted payroll or actual payroll. Footnote 3 further provides that comparisons between the ARC and contributions should be based on the same measure of covered payroll.

At the time the valuation is being done, the actuary may not know which payroll method will be used for reporting purposes. The actuary may not even know for which period the valuation will be used to determine the ARC. Furthermore, the actuary doesn't know if the client will make adjustments to the ARC in order to use it for the first year of the biennial or triennial period. (GASB 45 is silent on this.) Even if the actuary were to know all of these things, it would be a rare situation that would result in knowing the appropriate covered payroll number

## **Total Compensation Systems, Inc.**

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to report. For example, if the employer uses actual payroll, that number would not be known at the time the valuation is done.

As a result, we believe the proper approach is to report the ARC components as a dollar amount. It is the client's responsibility to turn this number into a percentage of payroll factor by using the dollar amount of the ARC (adjusted, if desired) as a numerator and then calculating the appropriate amount of the denominator based on the payroll determination method elected by the client for the appropriate fiscal year.

If we have been provided with payroll information, we are happy to use that information to help the employer develop an estimate of covered payroll for reporting purposes. However, the validity of the covered payroll remains the employer's responsibility even if TCS assists the employer in calculating it.



### APPENDIX F: GLOSSARY OF RETIREE HEALTH VALUATION TERMS

Note: The following definitions are intended to help a *non-actuary* understand concepts related to retiree health valuations. Therefore, the definitions may not be actuarially accurate.

Actuarial Accrued Liability: The amount of the actuarial present value of total projected benefits attributable to employees' past service based on the actuarial cost method used.

Actuarial Cost Method: A mathematical model for allocating OPEB costs by year of service.

Actuarial Present Value of Total Projected Benefits: The projected amount of all OPEB benefits to be paid to current and future retirees discounted back to the valuation date.

Actuarial Value of Assets: Market-related value of assets which may include an unbiased formula for smoothing cyclical fluctuations in asset values.

Annual OPEB Cost: This is the amount employers must recognize as an expense each year. The annual OPEB expense is equal to the Annual Required Contribution plus interest on the Net OPEB obligation minus an adjustment to reflect the amortization of the net OPEB obligation.

Annual Required Contribution: The sum of the normal cost and an amount to amortize the unfunded actuarial accrued liability. This is the basis of the annual OPEB cost and net OPEB obligation.

Closed Amortization Period: An amortization approach where the original ending date for the amortization period remains the same. This would be similar to a conventional, 30-year mortgage, for example.

Discount Rate: Assumed investment return net of all investment expenses. Generally, a higher assumed interest rate leads to lower normal costs and actuarial accrued liability.

Implicit Rate Subsidy: The estimated amount by which retiree rates are understated in situations where, for rating purposes, retirees are combined with active employees.

Mortality Rate: Assumed proportion of people who die each year. Mortality rates always vary by age and often by sex. A mortality table should always be selected that is based on a similar "population" to the one being studied.

Net OPEB Obligation: The accumulated difference between the annual OPEB cost and amounts contributed to an irrevocable trust exclusively providing retiree OPEB benefits and protected from creditors.

Normal Cost: The dollar value of the "earned" portion of retiree health benefits if retiree health benefits are to be fully accrued at retirement.

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<u>OPEB Benefits:</u>	Other PostEmployment Benefits. Generally medical, dental, prescription drug, life, long-term care or other postemployment benefits that are not pension benefits.
<u>Open Amortization Period:</u>	Under an open amortization period, the remaining unamortized balance is subject to a new amortization schedule each valuation. This would be similar, for example, to a homeowner refinancing a mortgage with a new 30-year conventional mortgage every two or three years.
<u>Participation Rate:</u>	The proportion of retirees who elect to receive retiree benefits. A lower participation rate results in lower normal cost and actuarial accrued liability. The participation rate often is related to retiree contributions.
<u>Retirement Rate:</u>	The proportion of active employees who retire each year. Retirement rates are usually based on age and/or length of service. (Retirement rates can be used in conjunction with vesting rates to reflect both age and length of service). The more likely employees are to retire early, the higher normal costs and actuarial accrued liability will be.
<u>Transition Obligation:</u>	The amount of the unfunded actuarial accrued liability at the time actuarial accrual begins in accordance with an applicable accounting standard.
<u>Trend Rate:</u>	The rate at which the cost of retiree benefits is expected to increase over time. The trend rate usually varies by type of benefit (e.g. medical, dental, vision, etc.) and may vary over time. A higher trend rate results in higher normal costs and actuarial accrued liability.
<u>Turnover Rate:</u>	The rate at which employees cease employment due to reasons other than death, disability or retirement. Turnover rates usually vary based on length of service and may vary by other factors. Higher turnover rates reduce normal costs and actuarial accrued liability.
<u>Unfunded Actuarial Accrued Liability:</u>	This is the excess of the actuarial accrued liability over assets irrevocably committed to provide retiree health benefits.
<u>Valuation Date:</u>	The date as of which the OPEB obligation is determined. Under GASB 43 and 45, the valuation date does not have to coincide with the statement date.
<u>Vesting Rate:</u>	The proportion of retiree benefits earned, based on length of service and, sometimes, age. (Vesting rates are often set in conjunction with retirement rates.) More rapid vesting increases normal costs and actuarial accrued liability.