City and County of San Francisco Retiree Health Care Trust Fund Board

Modeling a Pre-Funding Strategy

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Introduction

- Historically, post-retirement health care benefits had been funded strictly on a pay-as-you-go basis
  - Annual contributions equaled annual benefit payments
- Propositions B and C began to establish a pre-funding strategy, but the strategy is limited and to a large extent undefined after 2020
- Cheiron has worked with the City and County to develop a more robust pre-funding strategy

Introduction

- Transition to pre-funding requires a strategy to fund the benefits earned in prior years
- The strategy is largely a policy decision reflecting the City and County's view of generational equity
  - Under a **pay-as-you-go strategy**, the current generation of workers and taxpayers pays for the previous generation's benefits
  - Under a **pre-funding strategy**, the current generation of workers and taxpayers pays the estimated cost for the current generation's benefits
- In the transition from pay-as-you-go to pre-funding, how much should the current generation of taxpayers pay for the prior generation in addition to the estimated cost of the current generation?
  - Must ensure that promised benefits can be paid
  - Policy affects how much future generations of taxpayers will be expected to pay for prior generations

Current Funding Requirements

- For Prop B employees (hired on or after 1/10/2009), contributions to the Retiree Health Care Trust Fund (RHCTF) take effect immediately upon employment:
  - 2% of pay is contributed by the employee
  - 1% of pay is contributed by the City
- For Pre-Prop B employees, contributions to the RHCTF take effect beginning July 1, 2016:
  - 0.25% of pay is contributed by the employee in 2016, increasing 0.25% per year until the contribution level reaches 1% of pay in 2019
  - City contributions are equal to the employee contributions for pre-Prop B employees
- Contribution levels described above are minimum levels, additional contributions may also be made to the RHCTF
- No benefits will be paid from the RHCTF prior to January 1, 2020

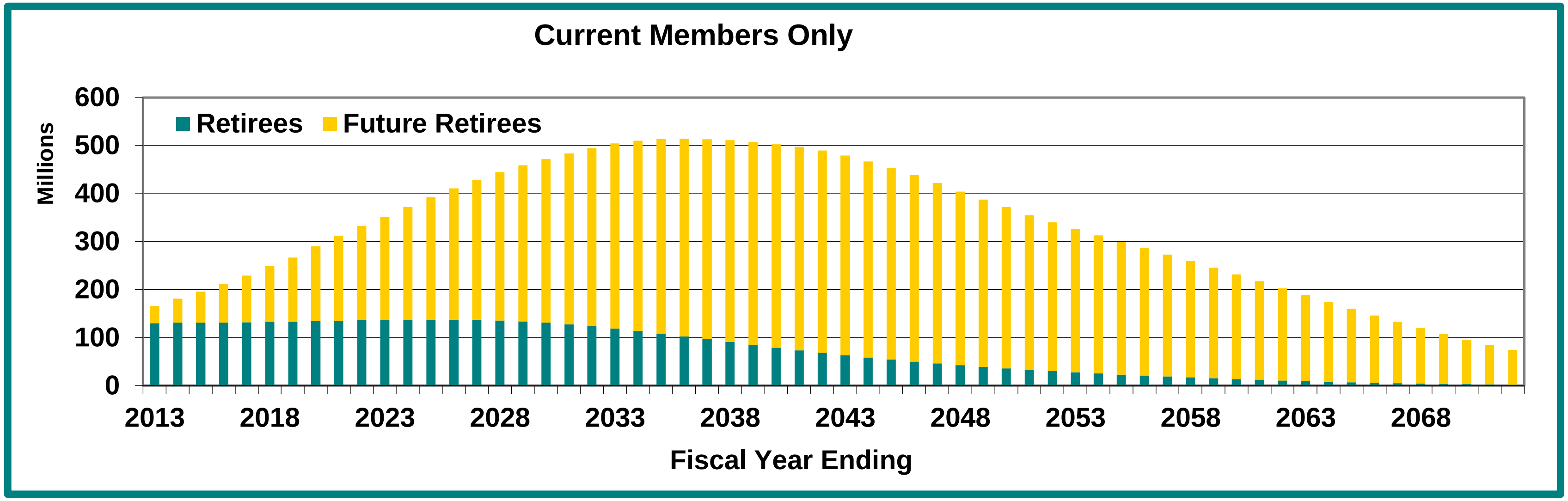
Proposed Pre-Funding Strategy

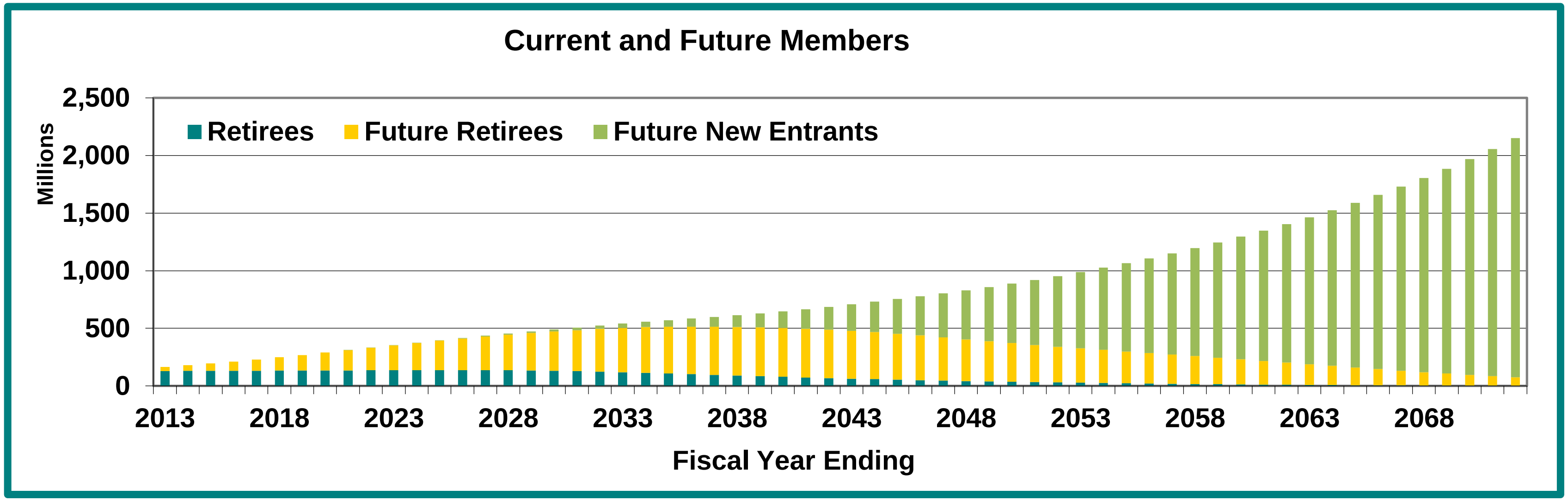
- Proposed pre-funding strategy was developed based on:
  - 60-year projections of the estimated liability for post-retirement health care benefits, projected contributions and benefit payments, and projected assets in the Retiree Health Care Trust Fund (RHCTF)
  - Stress tests of the projections by varying key assumptions
- A variety of strategies were modeled balancing the issues of generational equity, affordability, and sustainability

Proposed Pre-Funding Strategy

- Employee contributions required by Propositions B and C continue
- City contributions are as follows:
  - While the Plan is less than 100% funded:
    - City contributes amounts required by Propositions B and C plus pay-go costs up to a maximum total contribution of 10% of payroll
    - Pay-go costs in excess of the City's additional contribution are paid from RHCTF subject to a withdrawal limit of 10% of prior year RHCTF ending balance
    - Any pay-go costs above the withdrawal limit are paid by the City
  - While the Plan is at least 100% funded:
    - City contributes amounts described by Prop B/C to RHCTF
    - RHCTF pays benefit and administration costs
- It is possible RHCTF may pay some benefits prior to 2020

Estimated Future Pay-Go Costs

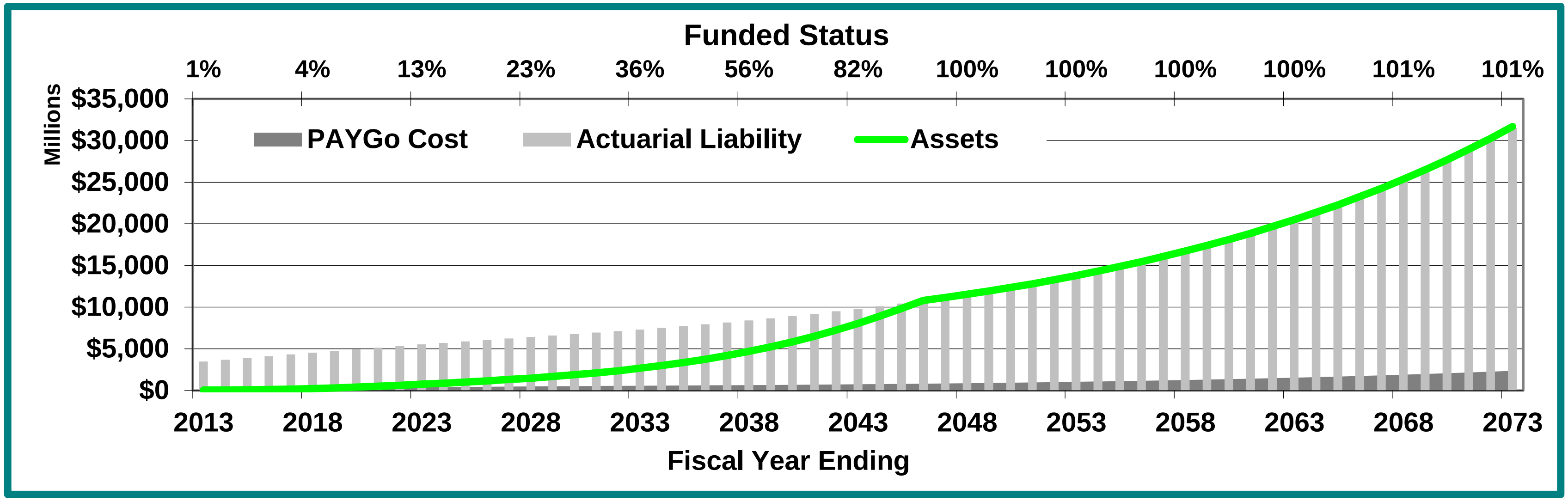


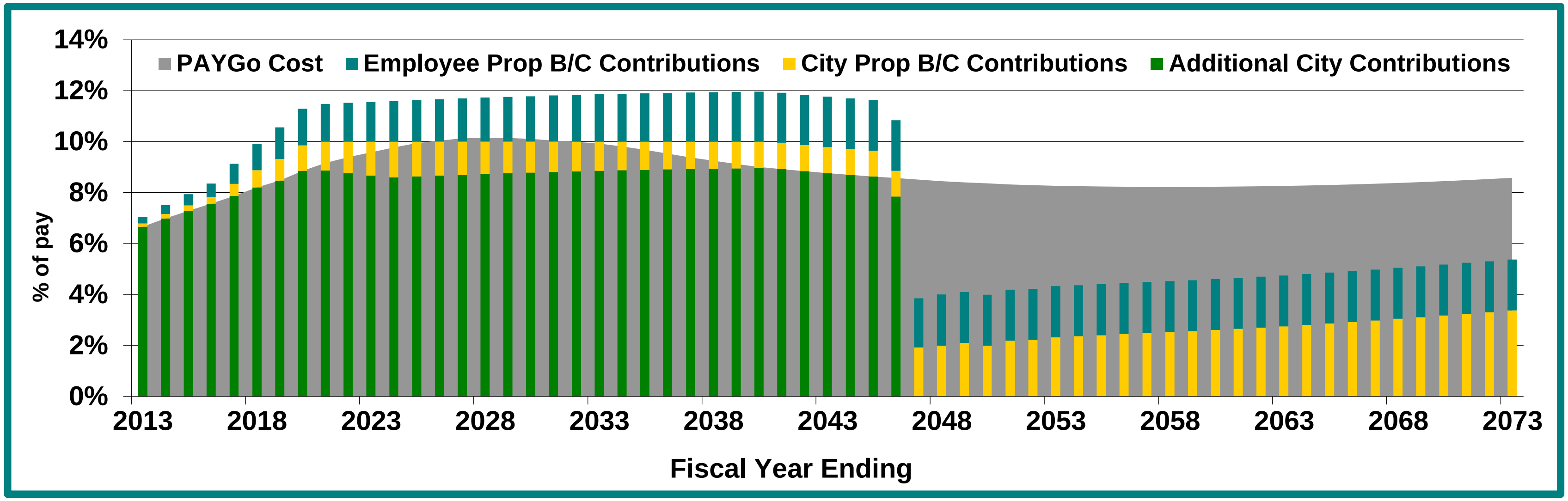


Projections – Key Assumptions

- All projections are shown using a discount rate equal to the long-term return on assets assumption (7.5%).
- Assets are assumed to return 4.25% per year until the RHCTF reaches $25 million in total assets, and 7.5% after
- All other assumptions are the same as the July 1, 2010 valuation. Please see the full valuation report for a summary of the plan provisions, methods, assumptions and data used
- For projection purposes:
  - The active population is assumed to remain stable (i.e., same count and same demographic characteristics)
  - Payroll is assumed to grow 4.0% annually
  - No future gains or losses are assumed

Pre-Funding Strategy Projection





Pre-Funding Strategy Observations

- The RHCTF is projected to first reach 100% funding in 2046
- City contributions are expected to reach the 10% maximum limit in 2021 and remain at the limit until 2040
- During these years, some pay-as-you-go costs are funded by RHCTF disbursements, but the 10% withdrawal limit is not reached in any year
- City contribution rate drops significantly when plan becomes 100% funded

Sensitivity Testing

- The following variances for key assumptions were tested to assess the sensitivity of the projections:
  - Investment return: 6.5% actual versus assumed 7.5%
  - Retirement rates: double currently assumed rates for two years versus assumed rates
  - Payroll growth: 3.25% actual vs. 4.00% assumed
  - Medical trend: parallel shift of 1% increase and decrease versus currently assumed rates
- The stress tests did not reflect any change in the assumptions used in each future valuation, but only a change in the projected experience of the plan

Sensitivity Testing

- In addition, we developed and tested two scenarios that illustrate the combined effects of several key assumptions:
  - Short-Term Shock Scenario
    - Initial 2-year spike in medical trend approximately reflecting highest historical 2-years since 2000 (13% for non-Medicare, 9% for Medicare-eligible)
    - Double retirement rates for first two years of projection
    - 0% payroll growth for first two years of projection
  - Long-Term Pessimistic Scenario
    - 6.5% actual investment return
    - 3.25% payroll growth
    - Current medical trend +1%

Sensitivity Testing Observations

- As expected, medical trends have the largest impact on projected results:
  - Shifting the trends +1% in all years results in the 10% cap on RHCTF disbursements being exceeded from 2020 to 2033 and the plan was 43% funded at the end of the projection period
  - If all trends are shifted -1%, the plan becomes 100% funded in 2039, 7 years earlier than the base case
- Payroll growth is also a key assumption:
  - If actual payroll growth is 3.25% instead of 4% each year, the projected date to be 100% funded is pushed back 14 years to 2060
- The projected results are less sensitive to retirement rate and investment return assumptions
- Short-term shock scenario would result in some payments from the RHCTF prior to 2020
- Given the sensitivity, any pre-funding strategy should have the flexibility to make necessary adjustments in the future

Questions

Required Disclosures

- The purpose of this presentation is to present the proposed pre-funding strategy to the Retiree Health Care Trust Fund Board for the City and County of San Francisco's Retiree Health Care Plan.
- This presentation is for the use of the City and County of San Francisco. Any other user is not an intended user and is considered a third party. This presentation is not intended to benefit any third party and Cheiron assumes no duty or liability to any such party.
- In projecting the pre-funding strategy, we relied without audit, on information (some oral and some written) supplied by the City and County of San Francisco, the Health Services System, and the San Francisco Employees' Retirement System. This information includes, but is not limited to, the plan provisions, employee data, and financial information. We performed an informal examination of the obvious characteristics of the data for reasonableness and consistency in accordance with Actuarial Standard of Practice #23. Please refer to the full July 1, 2010 actuarial valuation report for a complete description of the plan provisions, assumptions, methods and a summary of the data used in the actuarial valuation.
- We hereby certify that, to the best of our knowledge, this presentation has been prepared in accordance with generally recognized and accepted actuarial principles and practices which are consistent with the Code of Professional Conduct and applicable Actuarial Standards of Practice set out by the Actuarial Standards Board. Furthermore, as credentialed actuaries, we meet the Qualification Standards of the American Academy of Actuaries to render the opinion contained in this presentation. This presentation does not address any contractual or legal issues. We are not attorneys and our firm does not provide any legal services or advice.

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