

Commission Letter #: 140-11  
Commission Meeting: 05/16/2011  
RE: **Retiree Health Care Actuarial Valuation Report as of June 30, 2010**

May 11, 2011

The Honorable Mayor and City Commissioners:

The City's contracted actuary from Gabriel Roeder Smith & Company completed the June 30, 2010 Other Post Employment Benefits (OPEB) actuarial valuations report for the City's Retiree Health Care Plan. This report is required to be performed every two years. The report was developed in accordance with standards practiced by the Actuarial Standards Board. This communication hopes to serve as a summary report.

The purpose of the valuation is to determine the Retiree Health Care Plan's funding progress, the annual required contribution along with any unfunded actuarial accrued liabilities (other GASB 45 disclosure purposes).

The report provided the following information (as of June 30, 2010):

- The present value of future benefits expected to be paid is \$128,309,143.
- The actuarial accrued liability was \$116,791,220, as there was \$4,813,960 in valuation assets to offset liabilities making the Unfunded Actuarial Accrued Liability \$111,977,260.
- The system had a funded ratio of 4.1%.
- The City's contribution/ARC for the July 1, 2011 fiscal year should be \$10,808,249 down from two years ago when it was \$11,132,961.

Other information:

- The City is currently contributing \$7.4 M / 68% % of the ARC this fiscal year.
- The City contributed \$8.3 / 75% of the ARC in FY2009/10.
- The FY2011/12 City Manager's recommended budget calls for contributing 80% of the general employees ARC and 50% of police and fire (uniformed) employees ARC.

No action by the Commission is requested to be taken. The full report is enclosed and available on the City's website.

Respectfully submitted,



Julie Rudd  
Director of Finance

Approved,



Donald E. Johnson  
City Manager

**CITY OF ROYAL OAK RETIREE HEALTH CARE PLAN**  
**THE REPORT OF THE ACTUARIAL VALUATION**  
**AS OF JUNE 30, 2010**

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April 8, 2011

Ms. Julie Rudd  
Finance Director  
City of Royal Oak  
211 S. Williams Street  
Royal Oak, Michigan 48067

Dear Ms. Rudd:

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 Royal Oak. The date of the valuation was June 30, 2010, effective for the fiscal year July 1, 2011 thru June 30, 2012. This report was prepared at the request of the City of Royal Oak.

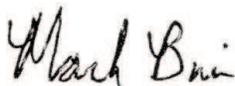
The actuarial calculations were prepared for purposes of complying with the requirements of Statement No. 45 of the Governmental Accounting Standards Board (GASB). In addition, we have included information which may be helpful if there is a trust requiring a GASB Statement No. 43 disclosure. The calculations reported herein have been made on a basis consistent with our understanding of these accounting standards. Determinations of the liability associated with the benefits described in this report for purposes other than satisfying the City's financial reporting requirements may produce significantly different results. This report may be provided to parties other than the City of Royal Oak only in its entirety and only with the permission of the City of Royal Oak.

The valuation was based upon information, furnished by the City, concerning retiree health benefits, individual members, 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.

The undersigned are Members of the American Academy of Actuaries and meet the Qualification Standards of the American Academy of Actuaries to render the actuarial opinion contained herein.

Respectfully submitted,



Mark Buis, FSA, EA, MAAA



Curtis Powell, EA, MAAA

MB:rmn

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## EXECUTIVE SUMMARY

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## EXECUTIVE SUMMARY

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### **Annual Required Contribution**

This report presents the annual expense required to be recognized by the plan sponsor for purposes of complying with the accounting requirements of Governmental Accounting Standards Board Statement No. 45.

The Annual Required Contribution (ARC) for the fiscal year beginning July 1, 2011 is \$10,808,249. In the first year GASB Statement No. 45 is adopted, the annual OPEB cost required to be disclosed on the employer's financial statements is equal to the ARC. In subsequent years, the annual OPEB cost is the ARC plus interest on the Net OPEB obligation plus an adjustment to the ARC. Actual premiums paid on behalf of retirees may be treated as employer contributions in relation to the ARC and act to reduce the Net OPEB Obligation (NOO). (See Below)

For additional details please see the section titled "Valuation Results".

### **Additional OPEB Reporting Requirements**

In addition to the annual OPEB cost described above, employers are required 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 employer chooses to recognize a beginning balance.

The requirements for determining the employer's contributions in relation to the ARC are described in paragraph 13 g. 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.

See Section titled "GASB Accounting Schedules" for additional accounting information.

## EXECUTIVE SUMMARY

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### **Liabilities and Assets**

The present value of all benefits expected to be paid to current plan members as of June 30, 2010 is \$128,309,143. The actuarial accrued liability, which is the portion of the \$128,309,143 attributable to service accrued by plan members as of June 30, 2010, is \$116,791,220. As of June 30, 2010, there is \$4,813,960 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, 2010 is 4.1%.

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## **SECTION A**

### **VALUATION RESULTS**

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**DEVELOPMENT OF THE ANNUAL REQUIRED CONTRIBUTION  
FOR THE OTHER POSTEMPLOYMENT BENEFITS  
FISCAL YEAR BEGINNING JULY 1, 2011**

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Contributions for	Development of the Annual Required Contribution for July 1, 2011 - June 30, 2012		
	General	Police & Fire	Total
Normal Cost			
Normal Retirement	\$ 555,135	\$ 589,070	\$ 1,144,205
Early Retirement	0	0	0
Termination Benefits	22,710	16,002	38,712
Death in Service	18,505	11,001	29,506
Disability	26,916	31,004	57,920
Future Refund of Member Contributions	<u>0</u>	<u>0</u>	<u>0</u>
Total Normal Cost	\$ 623,266	\$ 647,077	\$ 1,270,343
Annual Active Member Contribution	0	0	0
Employer Normal Cost	623,266	647,077	1,270,343
Amortization of Unfunded Actuarial Accrued Liabilities (Amortized over 28 years)	4,593,321	4,944,585	9,537,906
Annual Required Contribution (ARC)	5,216,587	5,591,662	10,808,249

The unfunded actuarial accrued liabilities were amortized as a level dollar amount over a period of 28 years. A 30-year amortization period for unfunded actuarial accrued liabilities is the maximum period that complies with GASB requirements.

**DETERMINATION OF UNFUNDED ACTUARIAL ACCRUED LIABILITY  
AS OF JUNE 30, 2010**

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	<b>General</b>	<b>Police &amp; Fire</b>	<b>Total</b>
A. Present Value of Future Benefits			
1. Retirees and Beneficiaries	\$41,100,038	\$44,905,714	\$ 86,005,752
2. Vested Terminated Members	1,705,906	0	1,705,906
3. Active Members	<u>19,176,336</u>	<u>21,421,149</u>	<u>40,597,485</u>
Total Present Value of Future Benefits	\$61,982,280	\$66,326,863	\$128,309,143
B. Present Value of Future Employer Normal Costs	5,736,984	5,780,939	11,517,923
C. Present Value of Future Contributions from Current Active Members	0	0	0
D. Actuarial Accrued Liability (A.-B.-C.)	56,245,296	60,545,924	116,791,220
E. Actuarial Value of Assets	2,318,347	2,495,613	4,813,960
F. Unfunded Actuarial Accrued Liability (D.-E.)	53,926,949	58,050,311	111,977,260

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.

The long term rate of investment return used in this valuation is 7.75%.

## COMMENTS

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**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 ARC. Lower returns will tend to increase the computed ARC. Based on information from the plan sponsor, we have calculated the liability and the resulting ARC using an assumed long term rate of investment similar to the Retirement System. If the Plan Sponsor chooses to pre-fund with contributions less than the ARC (or not pre-fund at all), GASB requires the use of a lower rate of return on assets. Use of such an interest rate would considerably increase the ARC and the net OPEB obligation that is disclosed on the employer's financial statement.

The ARC shown in this report has been calculated assuming that approximately the full ARC will be contributed each year. It is expected to remain approximately a level dollar amount until the unfunded liability is paid off. If an amount materially less than the full ARC is contributed, GASB requires use of a lower interest rate that would produce a much higher ARC. Shown below are results under 2 scenarios; 1) The City pays benefits on a pay-as-you-go basis, 2) The City contributes the full ARC each year. If the City's policy is to contribute an amount less than the full ARC but more than a pay-as-you-go basis, the results would fall between these amounts. Please consult with your auditor for the appropriate interest rate to use.

<b>Employment Group</b>	<b>4.00% Pay as You Go</b>	<b>7.75% Current</b>
<b>General ARC (\$)</b>	\$ 6,557,322	\$ 5,216,587
<b>Police &amp; Fire ARC (\$)</b>	\$ 7,477,886	\$ 5,591,662
<b>Total ARC (\$)</b>	\$14,035,208	\$10,808,249

## COMMENTS (CONCLUDED)

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**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. This permits fluctuations and trends in experience to be reflected in the contribution rate on a regular basis.

**COMMENT C:** The ARC decreased from \$11,132,961 in the June 30, 2008 valuation to \$10,808,249 in the June 30, 2010 valuation. The primary reason for the decrease was the changes in the retiree health care plan, specifically what options are available for future retirees.

**COMMENT D:** GASB Statement No. 45 stipulates that Plan assets must be placed in a trust or equivalent arrangement that meets the following criteria:

- Employer contributions to the Plan are irrevocable
- Assets are dedicated to providing benefits to retirants and their beneficiaries
- Assets are legally protected from creditors

Our calculations assume that the City established a qualified trust in which to deposit contributions.

**COMMENT E:** Legislative changes due to the Patient Protection and Affordable Care Act relating to retiree healthcare benefits have been reflected to the extent they have already been implemented in the Plan.

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**SECTION B**

**RETIREE PREMIUM RATE DEVELOPMENT**

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## RETIREE PREMIUM RATE DEVELOPMENT

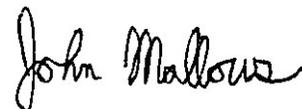
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Initial premium rates were developed for the two classes of retirees (pre-65 and post-65). In addition, separate rates were developed for police/fire and general retirees. The fully-insured rates provided by the City of Royal Oak were utilized to determine the appropriate premium rates. The pre-65 fully-insured premiums are blended rates based on the combined experience of active and pre-65 retired members; therefore, there is an implicit employer subsidy for the non-Medicare eligible retirees since the average costs of providing health care benefits to retirees under age 65 is higher than the average cost of providing health care benefits to active employees. The true per capita cost for the pre-65 retirees is developed by adjusting the demographic differences between the active employees and retirees to reflect this implicit rate subsidy for the retirees. For the post-65 retirees, the fully-insured premium rate is used as the basis of the initial per capita cost without adjustments since the rate reflects the demographics of the post-65 retiree group.

The benefit options available to future retirees are different than current retirees. We have developed separate premium rates for future retirees in order to reflect the benefit differences.

Age graded and sex distinct premiums are utilized by this valuation. The premiums developed by the preceding process 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 premiums more accurately reflect the health care utilization and cost at that age.

The undersigned is a Member of the American Academy of Actuaries (MAAA) and meets the Qualification Standards of the American Academy of Actuaries to certify the per capita retiree health care rates shown on the following page.



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John Mallows, FSA, MAAA  
Health Care Actuary

## RETIREE PREMIUM RATE DEVELOPMENT (CONCLUDED)

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The combined monthly one-person medical and drug premiums at select ages are shown below.

### GENERAL

<b>For Those Not Eligible for Medicare (Pre-65)</b>				
<b>Age</b>	<b>Future Retirees</b>		<b>Current Retirees</b>	
	<b>Male</b>	<b>Female</b>	<b>Male</b>	<b>Female</b>
40	\$ 284.39	\$ 445.56	\$ 354.25	\$ 555.02
50	522.75	592.31	651.18	737.83
60	858.33	825.04	1,069.20	1,027.74
64	999.05	926.03	1,244.50	1,153.53

<b>For Those Eligible for Medicare (Post-65)</b>				
<b>Age</b>	<b>Future Retirees</b>		<b>Current Retirees</b>	
	<b>Male</b>	<b>Female</b>	<b>Male</b>	<b>Female</b>
65	\$ 412.67	\$ 380.02	\$ 579.39	\$ 533.55
75	528.46	469.00	741.96	658.47
85	589.28	517.35	827.34	726.36

### POLICE/FIRE

<b>For Those Not Eligible for Medicare (Pre-65)</b>				
<b>Age</b>	<b>Future Retirees</b>		<b>Current Retirees</b>	
	<b>Male</b>	<b>Female</b>	<b>Male</b>	<b>Female</b>
40	\$ 241.71	\$ 378.70	\$ 343.29	\$ 537.84
50	444.31	503.43	631.03	714.99
60	729.54	701.24	1,036.11	995.93
64	849.14	787.07	1,205.98	1,117.83

<b>For Those Eligible for Medicare (Post-65)</b>				
<b>Age</b>	<b>Future Retirees</b>		<b>Current Retirees</b>	
	<b>Male</b>	<b>Female</b>	<b>Male</b>	<b>Female</b>
65	\$ 384.60	\$ 354.17	\$ 579.17	\$ 533.34
75	492.51	437.09	741.68	658.22
85	549.19	482.16	827.03	726.09

The dental and vision premiums were not “age graded” for this valuation since these claims do not vary significantly by age. The combined dental and vision rates used in this valuation are \$51.66 for General and \$51.76 for Police/Fire.

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**SECTION C**

**SUMMARY OF BENEFIT PROVISIONS**

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**CITY OF ROYAL OAK RETIREE HEALTH CARE PLAN**  
**SUMMARY OF BENEFITS AS OF JUNE 30, 2010**

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**Persons Covered**

Health insurance coverage is provided by and paid for by the City for the following people:

- to retired members of the Retirement System if they meet the eligibility requirements for post-retirement medical benefits (see next page);
- to spouses of eligible retirees during the retirees' lifetime;
- to surviving spouses after the eligible retiree's death for members who retired after June 1, 1980. Spousal coverage does not continue for those who retired prior to June 1, 1980;
- to employees who retire from a deferred status if they meet the minimum service requirements under their contract;
- eligible employees may elect to receive health insurance through their spouse's health care plan. The City will pay the employee 30% of the schedule applicable premium annually, up to a maximum of \$2,400.

**Groups Covered**

<b>Group</b>	<b>Date of Closure to New Hires</b>
Local 270M	7/1/2006
Department Heads and Deputies	7/1/2008
Professional & Technical	7/1/2007
AFSCME	7/1/2006
Foremen and Supervisors	7/1/2006
Judges	5/1/2008
Police Service Aides	3/1/2009
Police	3/1/2009
Fire	3/1/2009
Police Command	3/1/2009
Police Detectives	3/1/2009
Police/Fire Department Heads	3/1/2009

**CITY OF ROYAL OAK RETIREE HEALTH CARE PLAN**  
**SUMMARY OF BENEFITS AS OF JUNE 30, 2010**

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**Eligibility Requirements**

Current active members are eligible to receive City paid health insurance upon retirement if they meet the following requirements:

<u>Employee Group</u>	<u>Eligibility Requirements</u>
Department Heads, Deputy Dept. Heads & Executive Dept. Heads	10 years of service
Local 270M & Supervisors	15 years of seniority if hired on or before 8/1/94, 20 years of service otherwise
Professional & Technical	<i>If hired before 6/11/83:</i> Age 70 with 5 years of service; Age 65 with 10 years of service; Age 60 with 15 years of service. <i>If hired on or after 6/11/83:</i> 20 years of service
AFSCME	<i>If hired before 6/11/83:</i> Age 70 with 5 years of service; Age 65 with 10 years of service; Age 60 with 15 years of service. <i>If hired on or after 6/11/83:</i> 15 years of service
All others	20 years of service

**Benefits Provided**

Retirees and their spouses are provided medical, prescription drug, dental, and vision coverage as well as reimbursed their Medicare Part B premiums.

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## **SECTION D**

### **SUMMARY OF PARTICIPANT DATA**

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**TOTAL ACTIVE MEMBERS AS OF JUNE 30, 2010**  
**BY ATTAINED AGE AND YEARS OF SERVICE**

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Attained Age	Years of Service to Valuation Date							Totals	
	0-4	5-9	10-14	15-19	20-24	25-29	30 Plus	No.	Valuation Payroll
20-24									
25-29	5	2						7	\$ 412,776
30-34	7	13	3					23	1,441,128
35-39	1	12	18	1				32	2,105,743
40-44		14	19	34	3			70	4,692,417
45-49	1	7	16	13	15	2		54	3,530,907
50-54		7	14	12	19	5		57	3,637,951
55-59	1	6	8	5	6	1	3	30	1,761,096
60-64	1	2	4	1	1	1	1	11	619,677
65 & Over			2	1				3	171,687
<b>Totals</b>	<b>16</b>	<b>63</b>	<b>84</b>	<b>67</b>	<b>44</b>	<b>9</b>	<b>4</b>	<b>287</b>	<b>\$18,373,382</b>

While not used in the financial computations, the following group averages are computed and shown because of their general interest.

**Age:** 45.9 years  
**Service:** 14.5 years  
**Annual Pay:** \$64,019

**GENERAL ACTIVE MEMBERS AS OF JUNE 30, 2010**  
**BY ATTAINED AGE AND YEARS OF SERVICE**

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Attained Age	Years of Service to Valuation Date							Totals	
	0-4	5-9	10-14	15-19	20-24	25-29	30 Plus	No.	Valuation Payroll
20-24									
25-29	1	1						2	\$ 84,188
30-34	4	3	1					8	446,109
35-39		6	4	1				11	541,564
40-44		9	10	6	1			26	1,294,037
45-49	1	4	11	6	8	1		31	1,844,147
50-54		7	14	6	10	1		38	2,126,677
55-59	1	6	8	4	4		2	25	1,367,129
60-64	1	2	4	1		1	1	10	536,222
65 & Over			2	1				3	171,687
<b>Totals</b>	<b>8</b>	<b>38</b>	<b>54</b>	<b>25</b>	<b>23</b>	<b>3</b>	<b>3</b>	<b>154</b>	<b>\$8,411,760</b>

While not used in the financial computations, the following group averages are computed and shown because of their general interest.

**Age:** 48.9 years  
**Service:** 14.1 years  
**Annual Pay:** \$54,622

**POLICE AND FIRE ACTIVE MEMBERS AS OF JUNE 30, 2010**  
**BY ATTAINED AGE AND YEARS OF SERVICE**

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Attained Age	Years of Service to Valuation Date							Totals	
	0-4	5-9	10-14	15-19	20-24	25-29	30 Plus	No.	Valuation Payroll
20-24									
25-29	4	1						5	\$ 328,588
30-34	3	10	2					15	995,019
35-39	1	6	14					21	1,564,179
40-44		5	9	28	2			44	3,398,380
45-49		3	5	7	7	1		23	1,686,760
50-54				6	9	4		19	1,511,274
55-59				1	2	1	1	5	393,967
60-64					1			1	83,455
65 & Over									
<b>Totals</b>	<b>8</b>	<b>25</b>	<b>30</b>	<b>42</b>	<b>21</b>	<b>6</b>	<b>1</b>	<b>133</b>	<b>\$9,961,622</b>

While not used in the financial computations, the following group averages are computed and shown because of their general interest.

**Age:** 42.6 years  
**Service:** 14.9 years  
**Annual Pay:** \$74,899

**TOTAL RETIRED AND DEFERRED MEMBERS AS OF JUNE 30, 2010**  
**BY ATTAINED AGE**

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Attained Age	Retired Members	
	General	Police/Fire
Under 55	6	20
55-59	22	18
60-64	41	30
65 & Over	139	120
<b>Totals</b>	<b>208</b>	<b>188</b>

The number counts above only include those retirees who have elected to receive retiree health care coverage through the City of Royal Oak retiree health care plan.

Attained Age	Deferred Members	
	General	Police/Fire
Under 55	6	0
55-59	2	0
60-64	0	0
65 & Over	0	0
<b>Totals</b>	<b>8</b>	<b>0</b>

The number counts above only include those deferred vested who are eligible to receive retiree health care coverage through the City of Royal Oak retiree health care plan.

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**SECTION E**

**GASB ACCOUNTING SCHEDULES**

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**GASB STATEMENTS NO. 43 AND NO. 45**  
**REQUIRED SUPPLEMENTARY INFORMATION**

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Valuation Date	June 30, 2010
Actuarial Cost Method	Individual Entry Age
Amortization Method	Level Dollar Closed
Remaining Amortization Periods	28 Years
Asset Valuation Method	Market Value
Actuarial Assumptions:	
Investment Rate of Return	7.75%
Projected Salary Increases	3.5% - 7.3%
Health Care Cost Trend Rate	9% Initial 3.5% Ultimate

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**SECTION F**

**ACTUARIAL COST METHOD AND  
ACTUARIAL ASSUMPTIONS**

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## VALUATION METHODS

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**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 dollar amount required to fully amortize the UAAL over a 28 year period beginning on the valuation date. This UAAL payment does not reflect any payments expected to be made between the valuation date and the fiscal year for which the contributions in this report have been calculated.

**Actuarial Value of System Assets.** Market value of assets were reported to us to be used in conjunction with this valuation.

The following amortization factors were used in developing the Annual Required Contribution for the fiscal year shown.

<b>7.75% Interest</b>	<b>Fiscal Year Beginning July 01,</b>
	<b>2011</b>
General (Level Dollar)	11.7400
Police & Fire (Level Dollar)	11.7400

## ACTUARIAL ASSUMPTIONS

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*The rate of investment return* was 7.75% a year, compounded annually net after investment and administrative expenses.

The assumed real return is the rate of return in excess of price inflation. Considering other assumptions used in the valuation, the 7.75% nominal rate translates to a net real return of 4.25% a year.

*The rates of salary increase* used for individual members are in accordance with the following table. This assumption is used to project a member's current salary to the salaries upon which future contributions will be based.

Sample Ages	% Increase in Salary at Sample Ages				
	Merit and Seniority		Base (Economic)	Increase Next Year	
	General	Police/Fire		General	Police/Fire
20	3.84%	3.00%	3.50%	7.34%	6.50%
25	3.12%	3.00%	3.50%	6.62%	6.50%
30	2.68%	3.00%	3.50%	6.18%	6.50%
35	2.37%	2.10%	3.50%	5.87%	5.60%
40	2.14%	0.78%	3.50%	5.64%	4.28%
45	1.68%	0.24%	3.50%	5.18%	3.74%
50	1.14%	0.14%	3.50%	4.64%	3.64%
55	0.66%	0.04%	3.50%	4.16%	3.54%
60	0.16%	0.00%	3.50%	3.66%	3.50%
65	0.00%	0.00%	3.50%	3.50%	3.50%
Ref	5	225	0.035		

The number of active members is assumed to decrease in the future.

The payroll growth rate for financing Unfunded Actuarial Accrued Liabilities was assumed to be 3.5% per year.

*The mortality table* was 110% of 1994 Group Annuity Mortality Table.

<b>Sample Attained Ages</b>	<b>Probability of Dying Next Year</b>		<b>Future Life Expectancy (years)</b>	
	<b>Men</b>	<b>Women</b>	<b>Men</b>	<b>Women</b>
45	0.174%	0.107%	34.46	38.81
50	0.284%	0.157%	29.80	34.03
55	0.487%	0.252%	25.29	29.33
60	0.877%	0.488%	21.01	24.78
65	1.599%	0.950%	17.08	20.51
70	2.610%	1.510%	13.60	16.60
75	4.093%	2.495%	10.51	12.96
80	6.823%	4.334%	7.85	9.75
Ref	#261x1.1sb0yrs	#262x1.1sb0yrs		

This assumption is used to measure the probabilities of each benefit payment being made after retirement. For active members, the probabilities of dying before retirement were based upon the same mortality table as members dying after retirement and the probabilities of each benefit payment being made after retirement.

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

<b>Percent of Eligible Active Members Retiring Within the Next Year</b>			
<b>Retirement Age</b>	<b>General &amp; PSA</b>	<b>Retirement Service</b>	<b>Police &amp; Fire</b>
50	15%	25	35%
51	10%	26	35%
52	10%	27	35%
53	10%	28	20%
54	10%	29	20%
55	10%	30	20%
56	10%	31	20%
57	10%	32	20%
58	10%	33	20%
59	10%	34	20%
60	10%	35	20%
61	10%	36	20%
62	30%	37	20%
63	15%	38	20%
64	15%	39	20%
65	100%	40	100%
66	100%		
67	100%		
68	100%		
69	100%		
70	100%		
Ref	623		576

*Rates of disability* among active members.

<b>Sample</b>	<b>Percent Becoming Disabled Within Next Year</b>			
	<b>General</b>		<b>Police/Fire</b>	
	<b>Males</b>	<b>Females</b>	<b>Males</b>	<b>Females</b>
<b>Ages</b>				
20	0.07%	0.03%	0.10%	0.10%
25	0.09%	0.05%	0.15%	0.15%
30	0.10%	0.07%	0.25%	0.25%
35	0.14%	0.13%	0.30%	0.30%
40	0.21%	0.19%	0.70%	0.70%
45	0.32%	0.28%	0.80%	0.80%
50	0.52%	0.45%	0.95%	0.95%
55	0.92%	0.76%	1.10%	1.10%
Ref	#33x1	#34x1	#45x1	#45x1

*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 or disability). This assumption measures the probabilities of members remaining in employment.

Sample Ages	Service Index	Percent of Active Members Separating Within Next Year			
		General		Police/Fire	
		Males	Females	Males	Females
ALL	1	12.00%	12.00%	10.00%	10.00%
	2	9.00%	9.00%	7.00%	7.00%
	3	7.00%	7.00%	5.00%	5.00%
	4	5.00%	5.00%	4.00%	4.00%
	5	4.50%	4.50%	3.50%	3.50%
20	6 & Over	5.00%	5.00%	3.50%	3.50%
25		5.00%	5.00%	3.50%	3.50%
30		4.50%	4.50%	2.90%	2.90%
35		3.55%	3.55%	1.50%	1.50%
40		1.45%	1.45%	0.60%	0.60%
45		0.75%	0.75%	0.50%	0.50%
50		0.75%	0.75%	0.50%	0.50%
55		0.75%	0.75%	0.50%	0.50%
Ref		29 #55x1	29 #55x1	30 #54x1	30 #54x1

*Health cost increases* – See table below.

Year Beginning July* 1,	Medical & Drug	Dental & Vision
	2011	9.00%
2012	8.25	3.50
2013	7.50	3.50
2014	6.75	3.50
2015	6.25	3.50
2016	5.75	3.50
2017	5.25	3.50
2018	4.75	3.50
2019	4.25	3.50
2020 & Later	3.50	3.50

\* Except for Medicare Part B Reimbursement which increases on January 1 each year.

## MISCELLANEOUS AND TECHNICAL ASSUMPTIONS

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<b>Decrement Operation</b>	Disability and mortality decrements do not operate during the first 5 years of service. Disability also does not operate during retirement eligibility.
<b>Decrement Timing</b>	Decrements of all types are assumed to occur mid-year.
<b>Eligibility Testing</b>	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.
<b>Incidence of Contributions</b>	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.
<b>Marriage Assumption</b>	90% of males and females are assumed to be married for purposes of death-in-service benefits. Male spouses are assumed to be three years older than female spouses for active member valuation purposes.
<b>Pay Increase Timing</b>	Beginning of year.
<b>Medicare Coverage</b>	Assumed to be available for all covered employees on attainment of age 65.
<b>Election Percentage</b>	It was assumed that 90% of eligible future retirees would choose to receive retiree health care benefits through the City. Of those assumed to elect coverage, 80% of males and 80% of females in the General groups were assumed to elect two-person coverage and 90% of males and 90% of females in the Police/Fire groups were assumed to elect two person 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.
<b>Loads</b>	Liabilities for future retirees were increased 5% to account for changes in the plan at retirement. A .25% load was assumed for the reimbursement of prescription drug copays over 30 per year.

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**APPENDIX A**  
**OVERVIEW**

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## **GASB BACKGROUND**

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The purpose of this valuation is to provide information on the cost associated with providing postemployment benefits other than pensions, or OPEB, to current and former employees. The information is designed to assist you in complying with Governmental Accounting Standards Board (GASB) Statements No. 43 and No. 45. OPEB benefits are most often associated with postemployment health care, but cover almost any benefit not provided through a pension plan, including life insurance, dental and vision benefits. It is important to note that OPEB benefits, by definition, do not include benefits *currently* being provided to active employees – however, this report includes the liabilities for benefits expected to be paid to current active employees in the future when they retire.

GASB Statements No. 43 and No. 45 were released in the spring of 2004. GASB Statement No. 43 covers the accounting rules for OPEB *plans* while GASB Statement No. 45 describes the rules for *employers* sponsoring OPEB plans. Your auditor can assist you in determining which statements apply to your particular situation.

The specific items required to be disclosed on an OPEB sponsor's financial statements are described in detail in GASB Statements No. 43 and No. 45.

### **GASB Statement No. 45**

Among the requirements of Statement No. 45 are recognition each year of an expense called the Annual OPEB Cost, and the accumulation of a liability to be disclosed on the employer's Statement of Net Assets called the Net OPEB Obligation (NOO).

The fundamental items required to determine the Annual OPEB Cost and the NOO are:

- the Annual Required Contribution (ARC)
- the Employer's Contributions in relation to the ARC

Although GASB does not require OPEB contributions, it has chosen to call the base component of the annual OPEB cost the Annual Required Contribution. The ARC is provided in this report.

## **GASB BACKGROUND (CONTINUED)**

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Paragraph 13g. of Statement No. 45 states:

“An employer has made a contribution in relation to the ARC if the employer has:

1. made payments of benefits directly to or on behalf of a retiree or beneficiary,
2. made premium payments to an insurer, or
3. irrevocably transferred assets to a trust, or equivalent arrangement in which Plan assets are dedicated to providing benefits to retirees and their beneficiaries in accordance with the terms of the Plan and are legally protected from creditors of the employer(s) or plan administrator.

For each fiscal year shown in this report, we have provided the ARC and the estimated benefits and/or premiums (based on valuation assumptions).

The NOO is the cumulative difference between the Annual OPEB Cost each year and the Employer’s Contribution in relation to the ARC. The Annual OPEB Cost for a year is equal to:

- the ARC, plus
- interest on the prior year’s NOO, plus
- amortization of the prior year’s NOO.

The Annual OPEB Cost and NOO are generally developed by the Plan Sponsor’s auditor based on information contained herein and elsewhere.

### **GASB Statement No. 43**

If the Plan has assets for Statement No. 43 purposes, then certain additional information useful in complying with the Statement is contained in this report.

## GASB STANDARDS

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Unlike pension plans, OPEB plans often do not have a formal document detailing the specific terms of the plan. Under GASB Statements No. 43 and No. 45 the benefits to be accounted for are those provided by the *substantive plan* – loosely defined as the benefits covered by the plan as understood by the employer and plan members at the time of each actuarial valuation. The substantive plan provisions used in this valuation are summarized in the section titled “Summary of Benefit Provisions”.

GASB also requires that the calculations assume the terms of the substantive plan continue indefinitely. It has been argued that there is a likelihood future OPEB plan provisions would be different than the current substantive plan (due to rising health care costs or social changes) and therefore liabilities based on the current substantive plan may overstate what will actually occur. However, the GASB Statement is designed to measure liabilities for the plan as it currently exists. While it may be reasonable to assume future changes in the OPEB plan for other purposes, recognition of anticipated changes is not allowed for purposes of accounting for OPEB.

The specific items required to be disclosed on an OPEB sponsor’s financial statements are described in detail in GASB Statements No. 43 and No. 45. In general terms, though, the plan sponsor is required to disclose an annual OPEB cost, the funded status of the plan and the funding progress on the valuation date.

Although GASB does not require OPEB contributions, it has chosen to call the base component of the annual OPEB cost the Annual Required Contribution, or ARC. The ARC consists of the cost of benefits accruing in a year plus an amount calculated to amortize any unfunded actuarial accrued liability over a period of not more than 30 years.

The funded status of the plan is a ratio of the plan’s assets (if any) to the actuarial accrued liability on the valuation date. The plan is also required to disclose the cumulative difference between the ARC and the employer’s actual contribution to the plan. This amount is known as the Net OPEB Obligation (NOO). Each year, the NOO accumulates with interest, plus the difference between the ARC and actual contributions for the year, plus some technical adjustments. **For most plans the NOO is set to zero as of the effective date of the GASB OPEB standard. It is the NOO, and not the actuarial accrued liability, that will be disclosed on the employers’ Statement of Net Assets.**

## OPEB PRE-FUNDING

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Many employers fund retiree health 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 increase. 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 City. The GASB accounting standards noted in the previous section of the report can factor into decisions concerning the level of pre-funding.

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## APPENDIX B

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## GLOSSARY

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

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

**Actuarial Assumptions.** Estimates of future plan experience with respect to rates of mortality, disability, turnover, retirement, rate or rates of investment income and salary increases. Decrement assumptions (rates of mortality, disability, turnover and retirement) are generally based on past experience, often modified for projected changes in conditions. Economic assumptions (salary increases and investment income) consist of an underlying rate in an inflation-free environment plus a provision for a long-term average rate of inflation.

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

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

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

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

## **GLOSSARY (CONCLUDED)**

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**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.

**Implicit Rate Subsidy.** It is common practice for employers to allow retirees to continue in the employer's group health insurance plan (which also covers active employees), often charging the retiree some portion of the premium charged for active employees. Under the theory that retirees have higher utilization of services, the difference between the true cost of providing retiree coverage and what the retiree is being charged is known as the implicit rate subsidy.

**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 Postemployment Employee Benefits (OPEB).** OPEB are postemployment benefits other than pensions. OPEB generally takes the form of health insurance and dental, vision, prescription drugs or other health care 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.



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April 8, 2011

Ms. Julie Rudd  
Finance Director  
City of Royal Oak  
211 S. Williams Street  
Royal Oak, Michigan 48067

Dear Ms. Rudd:

**Re: Retirement Health Care Plan**

Dear Ms. Rudd:

Enclosed are 17 copies of our report of the actuarial valuation of the City of Royal Oak Retiree Health Care Plan.

Respectfully submitted,

Mark Buis

MB:rmn  
Enclosures