Via Electronic Mail

August 27, 2019

Ms. Jennifer Schembri
Office of Employee Relations
City of San José
200 E. Santa Clara Street
San José, CA 95113-1905

Ms. Monique Alonso
Messing, Adam & Jasmine LLP
235 Montgomery Street, Suite 828
San Francisco, CA 94104

Re: Potential Exemption to Remarriage Penalty

Dear Ms. Schembri and Ms. Alonso:

We understand that the bargaining parties have engaged in discussions about providing an exemption to the "remarriage penalty" for spouses of Police Officers who are killed in the line of duty. The purpose of this letter is to provide a preliminary actuarial analysis of the financial impact, if any, of such an exemption. A final analysis can be provided once there is a formal proposal to evaluate.

Background

When a Member dies before commencing retirement benefits, Section 3.36.1200.F.3 of the San José Municipal Code provides that

> "the monthly allowance payable to the surviving spouse or surviving domestic partner shall be paid until the surviving spouse or surviving domestic partner marries, establishes a domestic partnership or dies, whichever is the earlier date, and no longer."

We understand that this provision is referred to as the "remarriage penalty." Section 3.36.1290.A provides an exemption to the "remarriage penalty"

> "if the surviving spouse or surviving domestic partner of a deceased member who, at the time of death is not a tier 2 member and is fifty-five years of age and is entitled to credit for twenty years of service, or who is entitled to be credited with thirty years of service regardless of whether such member has attained the age of fifty-five…."

The proposal would add an additional exemption to the "remarriage penalty" in the event an officer is killed in the line of duty.

Financial Impact on Valuation

In the annual actuarial valuation that is used to determine contributions to the Plan, we assume probabilities of death at each age for each member. We also assume that 50% of deaths while a member is an active employee are service-related, and that 85% of members are married at the time of death before retirement. Survivor benefits are calculated in accordance with the terms of the Plan, and we assume that survivor benefits payable to a spouse or domestic partner are payable for the remainder of their life. That is, we assume that they do not re-marry or establish a domestic partnership if the "remarriage penalty" would apply. They have a strong financial incentive not to re-marry and can adapt their personal lives accordingly. Consequently, any exemptions to the remarriage penalty would not affect the valuation or the contributions required to fund the Plan based on the current assumptions.

However, the assumptions used in the valuation are never precisely correct each and every year. As part of the valuation, we calculate a gain or loss compared to the assumptions, and we establish an amortization payment or credit over a 15-year period to pay for the gain or loss. If a surviving spouse or domestic partner subject to the "remarriage penalty" does re-marry or establish a domestic partnership resulting in the termination of survivor benefits, it would create an actuarial gain compared to the current valuation assumptions.

Historical Experience

The Office of Retirement Services identified five Police Officers who were killed in the line of duty since 1985, and survivor benefits continue to be paid to the Officer's spouse in all five cases. The only time a benefit has been forfeited due to remarriage was for the beneficiary of a Fire member.

Three of the survivor benefits commenced more than 30 years ago, and as of July 1, 2019, the value of the remaining benefits based on the assumptions used in the 2018 valuation averages over $0.5 million per survivor. For the two more recent deaths, the value of the remaining benefits averages about $1.2 million each. These are strong financial incentives not to re-marry.

Conclusions

Whether or not the re-marriage penalty is eliminated, we will continue to assume that beneficiaries do not re-marry if it would cause them to forfeit their benefits. As a result, there will be no difference in contribution requirements or funded status due to the elimination of the re-marriage penalty until a beneficiary actually re-marries. If a beneficiary re-marries and is subject to the forfeiture of his or her benefits, the Plan would experience a gain at that time that would very marginally reduce contribution requirements and improve funded status. If a beneficiary re-marries, but is no longer subject to the forfeiture of his or her benefits, it will be impossible to know for certain if the re-marriage would have happened if the re-marriage penalty had remained in place.

In preparing this analysis, we relied on information (some oral and some written) supplied by the San José Office of Retirement Services. 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 No. 23.

This letter and its contents have been prepared in accordance with generally recognized and accepted actuarial principles and practices and our understanding of the Code of Professional Conduct and applicable Actuarial Standards of Practice set out by the Actuarial Standards Board as well as applicable laws and regulations. Furthermore, as credentialed actuaries, we meet the Qualification Standards of the American Academy of Actuaries to render the opinion contained in this letter. This letter does not address any contractual or legal issues. We are not attorneys and our firm does not provide any legal services or advice.

This letter was prepared exclusively for the City of San José and the Police Officers Association for the purpose described herein. Other users of this letter are not intended users as defined in the Actuarial Standards of Practice, and Cheiron assumes no duty or liability to any other user.

Sincerely,
Cheiron

William R. Hallmark, ASA, EA, FCA, MAAA
Consulting Actuary

Anne D. Harper, FSA, EA, MAAA
Consulting Actuary

cc: Roberto Peña