## Agenda Item 5

October 16, 2012

**ITEM NAME:** Long-Term Care Premium Rates

**PROGRAM:** CalPERS Long-Term Care Program

**ITEM TYPE:** Action

**RECOMMENDATION**

Staff recommends the adoption of the following actions for the CalPERS Long-Term Care Program (LTC Program).

a. Implement a rate increase of 85 percent for specific LTC1 and LTC2 policies to be levied over a two-year period, beginning in 2015;
b. Offer a 10-year long-term care policy with Retained Inflation (RI);
c. Extend the RI option to all policies with built-in inflation protection; and
d. Include an Optional Daily Benefit Amount (DBA) purchase option for policyholders who dropped their built-in inflation protection or decreased their DBA after the 2010 premium increase.

**EXECUTIVE SUMMARY**

This agenda item is a follow-up to the strategic direction provided by the Pension and Health Benefits Committee on September 11, 2012. The premium increase amount necessary effective July 1, 2015, to stabilize the CalPERS Long-Term Care (LTC Fund) and achieve a 10 percent margin is approximately 79 percent when applied one-time, which would equate to approximately 85 percent when applied over two-years due to mathematical compounding. This premium increase presents the opportunity for CalPERS to offer a new benefit level that extends a combination of a 10-year benefit period and RI, expands RI to all policies currently offering inflation protection, and introduces an Optional DBA. These recommendations are designed to achieve the following objectives: a) ensure the LTC Fund solvency by applying a premium increase effective 2015 to those plan policies that present a greater liability to the LTC Fund resulting from initial underwriting, pricing, and claims experience, b) provide new benefit options for members with lifetime benefits and built-in inflation protection for LTC1 and LTC2 plans, and c) end the ongoing 5 percent premium increase in 2014 for LTC1 members with lifetime and inflation policies.

**BACKGROUND**

Approximately 76 percent of the policies issued for this program are LTC1 and LTC2 with inflation protection or lifetime without inflation protection. As of June 2012, the LTC Program membership stands at 150,330 members.

Similar to other long-term care insurance companies, the LTC Program has experienced:

- Worse-than-expected morbidity (i.e., claims), due in part to less stringent underwriting standards in the mid-1990's
- Higher-than-expected claims incidence
- Lower-than-expected investment income

Combined, these items have adversely impacted the financial status of the LTC Fund; therefore, similar to the commercial long-term care insurance industry, CalPERS has implemented various corrective actions, including increasing policy premiums. These premium increases were implemented across all policy types in 2003, 2007, and 2010. These initial mitigation efforts were not sufficient to address the structural defects, and the Board instituted 5 percent annual increases for LTC1 policies with lifetime coverage and inflation protection beginning in 2011.

On April 17, 2012, the Board adopted a more conservative LTC Fund asset allocation, reducing the percentage of private equity in the LTC Fund. A 5.75 percent discount rate, corresponding to this approach to investment, was adopted by the Committee on September 11, 2012. At that same meeting, the Committee provided direction to staff to develop recommendations for premium increases.

At a constituent meeting held on September 21, 2012, staff presented restructuring scenarios, which would end the ongoing 5 percent rate increase for LTC1 policies with lifetime coverage and inflation beginning in 2014 and require a premium increase beginning in 2015. These actions are necessary to stabilize the LTC Fund and achieve a 10 percent margin. Without the adoption of these actions, the projected claims of LTC1 and LTC2 policyholders compared to the projected cash flow from premiums are not aligned as the claims costs are projected to exceed the cash flow for these policies (Attachment 1).

Staff also presented an RI option that would allow policyholders with built-in inflation protection the option to drop their built-in inflation protection increases in the future but maintain the coverage amounts they have accrued and paid for over the years. We propose a 10-year policy with RI, which would allow policyholders with lifetime and built-in inflation protection benefits a new option to convert their lifetime coverage amount to a fixed year coverage plan while maintaining the benefits of their initial plan offering under their original Evidence of Coverage. Currently, lifetime policyholders can only decrease to a 6-year or 3-year comprehensive or facilities only plan, or move to a lower duration Partnership plan.

The Optional DBA is for policyholders who elected to remove their built-in inflation protection any time following the 2010 premium increase and did not retain their inflated DBA. This Optional DBA is also available to policyholders that decreased their DBA to mitigate a premium increase but maintained the built-in inflation protection on this new, lower DBA. This option would allow policyholders to repurchase up to 100 percent of their inflated DBA in effect at the time they requested that their built-in inflation protection benefit be removed or decreased the DBA at any time following the 2010 premium increase.

**ANALYSIS**

The LTC Program benefit plans that would be subjected to the projected 85 percent premium increase for 2015 are:

- LTC 1: Offered from 1995 – 2002 Comprehensive or Facility Only
    - All plans with inflation protection and lifetime without inflation protection
- LTC 2: Offered from 2003 – 2004 Comprehensive or Facility Only
    - All plans with inflation protection and lifetime without inflation protection

The following plans would be excluded from the 2015 premium increase:

- LTC 1: Offered from 1995 – 2002 Comprehensive or Facility Only
    - 6 or 3-Year plans without inflation protection
- LTC 2: Offered from 2003 – 2004 Comprehensive or Facility Only
    - 6 or 3-Year plans without inflation protection
- LTC 3: Offered from 2005 – 2008
    - Comprehensive or Facility Only
    - Unlimited, 6-Year, or 3-Year plan
- All California Partnership plans
- Conversions to 10, 6, or 3-year plan with retained inflation

The proposed premium increase was based on an assumption that 10 percent of LTC1 and LTC2 policyholders of lifetime plans with inflation protection would choose to convert to a 10-year/RI policy when offered in July 2013. Long-term care constituents were asked their preference for a one-time rate increase of 79 percent or a smoothing of the rate increase over 2, 3 and 5 years. (Attachment 2A) After the meeting, constituents were also given the opportunity to state their preference in writing to LTC Program staff. While only a small number of constituents responded, those that did so leaned toward the one-year, one-time only rate increase, or two-year smoothing option.

Attachment 2B and 2C are based on the same assumptions described above, yet project a 15 and 20 percent migration rate and reflect the resulting premium increase that would be implemented July 2015. Staff recommends the 10 percent migration assumption based on historical experience and to help mitigate the need for potential future increases if the migration target is not met.

The financial impact of the 85 percent premium increase on individual policyholders depends on their attained age and whether or not they are subject to the ongoing 5 percent rate increase (Attachment 3). Premiums for LTC1 and LTC2 comprehensive lifetime plans with inflation protection based on attained age groups as of 2011 are displayed ranging from 50 to 70 years of age, in 10-year increments. Sample monthly premium rates are displayed for each age group and the resulting ongoing 5 percent premium increases are applied to the LTC1 policies only.

For example, in 2010 a 60-year old LTC1 policyholder with comprehensive lifetime coverage had a monthly premium of $158. The ongoing 5 percent increase in 2011 resulted in an additional $8 per month, bringing the 2011 monthly premium up to $166. Ongoing annual increases are projected for 2012 through 2014. In 2015, the policyholder makes no change to her policy and receives an increase of $152 raising the monthly premium to $344.

For LTC2, in 2010 a 60-year old policyholder with comprehensive lifetime coverage had a monthly premium of $219. The ongoing 5 percent does not apply to LTC2 policies. In 2015, the policyholder makes no change to her policy and receives an increase of $173 raising the monthly premium to $392.

<u>Benefit Options for Converting Lifetime and Inflation Protection Policies</u>

1. Retained Inflation: RI will be offered to all policyholders who have policies with built-in inflation protection (excluding Partnership policies), regardless of their policy term. Without the RI option, when policyholders drop their built-in inflation protection, their inflated DBA reverts back to their original DBA at time of initial purchase. Policyholders electing to drop their built-in inflation protection would be eligible for the Benefit Increase Option (BIO), allowing them to increase their DBA amount without going through underwriting. The LTC Program offers the BIO every three years to all policyholders that do not have built-in inflation protection. Accepting the BIO offer results in a premium increase that correlates with the coverage increase afforded by this offer.

2. 10-Year/RI: The addition of a 10-year/RI plan with a BIO for comprehensive or facilities only policies affords policyholders an opportunity to convert to a 10-year option in addition to the currently available 6 and 3-year options. This option is only available to policyholders who have policies including a lifetime plan with inflation protection.

3. Optional DBA: The addition of the Optional DBA provides a means for policyholders who have reduced their DBA or dropped inflation protection to avail themselves of higher DBAs, should they elect to purchase this option. Participation in the Optional DBA requires the policyholder to participate in the RI plan option; therefore, those policyholders who previously elected to keep their

built-in inflation protection and decrease their DBA would be required to drop their built-in inflation protection and move into the RI benefit plan option.

If policyholders avail themselves of the above options, it will:

- Eliminate the ongoing 5 percent rate increase for LTC1 lifetime with inflation protection policyholders;
- Help them avoid the 2015 projected 85 percent premium increase; and
- Give them the BIO option every three years.

**BENEFITS/RISKS**

The benefits of implementing the 85 percent projected rate increase in 2015 and 2016 and the plan benefit changes are the following:

- Increase solvency and sustainability of the LTC Fund to achieve and maintain a 10 percent margin
- End the ongoing 5 percent premium increases
- Reduce liability to the LTC Fund through migration of policies with lifetime benefits and built-in inflation protection to a fixed term policy with no inflation protection
- Potentially lower premium rates for policyholders that convert
- Provide additional alternatives for the LTC1 and LTC2 policyholders to avoid a large premium increase proposed for 2015
- Increase the potential for re-opening the LTC Program for new business
- Provide policyholders clearer direction with respect to future premiums

The risk of implementing the 85 percent projected rate increase in 2015 and 2016 and the plan benefit changes are the following:

- Potentially lead to policyholder dissatisfaction
- Potentially increase policy cancellations and lapse rate attributed to rate increases
- Potentially fall below projected assumptions with regard to migration and conversion to the optional benefit changes, which may likely translate into a higher percentage rate increase for those policyholders who choose to keep lifetime policies and all policies with inflation protection coverage
- Increase risk of a delay with implementing system programming for the optional benefit changes for 2013, which could result in reworking assumptions and modifying the premium increase projection

Taking action now makes clear the necessary increases and provides policyholders with certainty about alternatives to the 2015 rate increase.

**ATTACHMENTS**

Attachment 1: Historic and Base Case Projected Cash Flows

Attachment 2A: Projected Percentage of 2015 Premium Increase-10 Percent Migration
Attachment 2B: Projected Percentage of 2015 Premium Increase-15 Percent Migration
Attachment 2C: Projected Percentage of 2015 Premium Increase-20 Percent Migration
Attachment 3: Monthly Premium Scenarios

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