Agenda Item 5

October 15, 2013

ITEM NAME: Long-Term Care Program Annual Valuation

PROGRAM: Actuarial Office

ITEM TYPE: Action

RECOMMENDATION
Approve the June 30, 2013, actuarial valuation report for the Long-Term Care (LTC) Program.

EXECUTIVE SUMMARY
This agenda item provides the results of the California Public Employees' Retirement System (CalPERS) LTC Program annual actuarial valuation for the fiscal year ending June 30, 2013. A copy of the actuarial valuation report is attached to this agenda item.

This actuarial valuation reflects the Stabilization Plan that was approved by the Board of Administration (Board) in October 2012, that included premium increases for certain policies and permitted policy conversions for members to move to a less expensive policy.

As a result of the Stabilization Plan approved by CalPERS Board, the funded status and the margin have both increased over the last year. As of June 30, 2012, the funded status for the LTC Program was 96 percent and the margin was negative 4.66 percent. The funded status as of June 30, 2013, is now 123 percent and the margin is 19.66 percent.

STRATEGIC PLAN
This agenda item supports the Strategic Plan Goal A - Improve long-term pension and health benefit sustainability.

BACKGROUND
The CalPERS LTC Program started in 1995 and the current Program has 144,933 members. Information on the types of policies offered through the program and the number of policy holders under each type can be obtained in Appendix E in the valuation report attached to the agenda item.

This is the first actuarial valuation report prepared internally by CalPERS actuarial staff. Prior actuarial valuations were performed by outside actuarial firms retained by CalPERS. The June 30, 2012, actuarial valuation was prepared by United Health

Actuarial Services, Inc. (UHAS). As this was the first year for CalPERS actuarial staff to perform the actuarial valuation, UHAS assisted greatly in the preparation of this valuation ensuring our valuation results were consistent with theirs.

Similar to LTC insurance providers, the CalPERS LTC Program has experienced worse than expected morbidity, higher than expected claims and lower than expected investment income since its inception. CalPERS has taken corrective actions to stabilize the LTC Fund including a series of rate increases and changes to the asset allocation. The most recent change was the adoption of the Stabilization Plan in October 2012, that included premium increases for certain policies and permitted policy conversions for members to move to a less expensive policy.

ANALYSIS

Funded Status and Margin for the Program

The results of the actuarial valuation are based on the inforce data and fund balance as of June 30, 2013. The funded status as of June 30, 2013, is 123 percent and the margin is 19.66 percent.

The following table shows how the funded status and margin were derived and compares the key results from the valuation to the key results from the June 30, 2012, actuarial valuation.

Component	6/30/2013 ($ in Millions)	6/30/2012 ($ in Millions)
1. Present Value of Future Benefits	$6,110	$6,693
2. Present Value of Future Expenses	$353	$371
3. Present Value of Future Premiums (PVFP)	$3,455	$3,425
4. Valuation Liabilities (= 3 – 1 – 2)	($3,008)	($3,639)
5. Valuation Assets	$3,687	$3,479
6. Valuation Margin (= 5 + 4)	$679	($160)
7. Margin as a % of PVFP (= 6 / 3)	19.66%	(4.66%)
8. Funded Status (= 5 / 4)	123%	96%

Even though the margin for the LTC Program is 19.66 percent as of June 30, 2013, it is important to remember that there are many variables including investment return and morbidity that can easily bring the margin down below the 10 percent target. For example, one year of negative investment return would significantly reduce the margin. An example of lower return rates is demonstrated on pages B-5 through B-7 of the valuation. Similar to the pension program, the LTC program has a long term horizon and changes should not be made simply in reaction to short term gains due to better than expected experience. Experience of the program should be reviewed and monitored annually for long-term trends to make sure the Program will be stable over the next 60 years.

Please refer the “Risk Analysis” section on pages 19 to 23 of the attached valuation report for more information on how sensitive the margin of the LTC Program is to changes in the key actuarial assumptions.

Main Reasons for Changes in Margin
As shown in the table below, the margin improved by more than 24 percent between the 2012 and 2013 valuations. The Stabilization Plan that was adopted by the CalPERS Board in October of 2012 improved the margin by more than 27 percent. As part of the Stabilization Plan, LTC participants subject to premium increases were provided the ability to convert to a less expensive policy. In the 2012 valuation, it was assumed that 10 percent of participants would elect to convert. The actual conversion rate was 28 percent for those members who were offered a conversion option in 2013. The higher than expected conversion rates increased the margin of the LTC Program by 4 percent in 2013. The impact of conversions is included in the table below as part of the impact of the Stabilization Plan.

The Program suffered an investment loss during 2012-13 fiscal year as a result of an investment return of 3.4 percent, which was lower than the assumed 5.75 percent discount rate assumption. The lower than expected return resulted in a decrease in the margin. The Program had a slight demographic experience loss that was due to more policies on claim with higher disabled life reserves. Adjustments were made to the actuarial assumptions, specifically changes to the morbidity, lapse rates and expense assumptions as well as changes to the conversion rates to better reflect actual experience over the last 12 months. The aggregate impact of these assumption changes was a decrease in margin. The table below provides a detailed reconciliation as to the factors that contributed to the improvements in margin.

	Results as a Present-Value of Premiums
Margin as of 6/30/12:	(4.66%)
Demographic experience loss	(0.36%)
Investment loss for FY 2012-2013	(2.17%)
Stabilization Plan adopted by the Board	27.43%
Revised assumptions	(1.13%)
Other (including impact of in-house actuarial model)	0.55%
Margin as of 6/30/13:	19.66%

For more information on the experience of each key actuarial assumption in the last fiscal year, please refer to the “Summary of Key Assumptions” section in the attached valuation report.

History of Funded Status and Margin

The funded status and margin/(deficit) have fluctuated greatly over the last few years as a result of plan experience, the investment return assumption changes in 2010 and 2012 and premium rate adjustment in 2010 and 2013. The table below shows the funded status and the margin/(deficit) for the LTC Program for the last 5 years.

5 Year History of Funded Status and Margin

Valuation Date	Funded Status	Margin
June 30, 2009	73%	(32.60%)
June 30, 2010	97%	(2.98%)
June 30, 2011	127%	23.14%
June 30, 2012	96%	(4.66%)
June 30, 2013	123%	19.66%

BUDGET AND FISCAL IMPACTS

The June 30, 2013, actuarial valuation was prepared internally. Funding was already identified within existing budgetary resources.

BENEFITS/RISKS

The actuarial calculations performed as part of the actuarial valuation are based on a number of assumptions about very long-term demographic and economic behavior. Unless these assumptions (morbidity, lapses, deaths, expenses, and investment return) are exactly realized each year, there will be differences on a year-to-year basis. The year-to-year differences between actual experience and the assumptions are called actuarial gains and losses and either increase or decrease the funded status and margin of the LTC Program. If the actual experience differs from the assumption over a prolonged period, it may result in a need for premium changes to ensure the financial integrity of the LTC Program. To minimize the risk that actual experience is not in line with assumptions, actuarial assumptions are periodically revised as they were in this valuation.

One of the key assumptions that poses the most risk to the program if not realized is the investment return. LTC insurance is characterized by level premiums and increasing claim costs over the coverage period. The collected premiums are invested, and the aggregate premiums plus investment income are used to pay out future claims. Investment income is a significant component of the income as the block of insurance matures. If investment returns were to be lower than expected over a prolonged period then more premiums would be needed to make up for the reduced growth in assets. Estimates from the American Association for Long Term Care Insurance (AALTCI) are that every 1 percent decrease in interest rates leads to a 10-15 percent increase in required premiums.

Other assumptions that could have a significant impact on the LTC Program if not realized over a long period of time include the morbidity assumption (i.e. amount of claims paid each year), lapses and mortality. Please refer the “Risk Analysis” section of the attached valuation report for more information on how sensitive the margin of the LTC Program is to changes in the key actuarial assumptions.

ATTACHMENTS

Attachment 1 - Actuarial Valuation Report of the CalPERS Long-Term Care Program as of June 30, 2013.

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