Agenda Item 9

November 19, 2013

ITEM NAME: Long-Term Care Financing Options

PROGRAM: CalPERS Long-Term Care Program

ITEM TYPE: Information

EXECUTIVE SUMMARY

The June 30, 2013, Long-Term Care (LTC) Fund Annual Actuarial Valuation (Actuarial Valuation) demonstrated a 19.66 percent margin. Consistent with the Pension and Health Benefits Committee's (PHBC) commitment, this agenda item describes options that can be considered to preserve the LTC Fund's sustainability and stabilize premium rates for our current participants. 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 LTC Program will be stable.

STRATEGIC PLAN

This agenda item supports the Strategic Plan Goal A – Improve long-term pension and health benefit sustainability, as well as, Business Objectives 3.4 and 3.5 in the 2012-2014 California Public Employees' Retirement System (CalPERS) Business Plan to stabilize and sustain the LTC Program.

BACKGROUND

The presentation of the 2013 LTC Actuarial Valuation at the October 2013 PHBC meeting, demonstrated an improvement in the LTC Program's funded status. The Board of Administration has established a goal that the Fund demonstrate a 10 percent margin. The most recent valuation showed a 19.66 percent margin, 9.66 percent above the target. The LTC Actuarial Valuation provided evidence of the effectiveness of the 2012 stabilization efforts approved by the Board and implemented over the past two years. In summary, the following actions were approved:

- Adoption of a more conservative LTC Fund asset allocation on April 17, 2012, and a 5.75 percent discount rate on September 18, 2012;

- Discontinuance of the five percent premium increases after July 1, 2014, for participants with Lifetime coverage and built-in Inflation Protection purchased between 1995 and 2002;

- Implementation of 10, 6 and 3-Year benefits with Retained Inflation as a coverage change option to avoid the 2013-16 premium increases with expectation of at least a 10 percent conversion rate from Lifetime to alternative benefit coverage; and,

- Adoption of an 85 percent premium increase to be applied over a two-year period beginning in 2015, for participants with Lifetime coverage or with built-in Inflation Protection.

ANALYSIS

The actuarial calculations supplied in the 2013 Actuarial Valuation are based on a number of assumptions about very long-term participant demographic and economic behavior. The year-to-year differences between actual experience and the assumptions supporting the margin are called actuarial gains and losses and either increase or decrease the funded status and margin of the LTC Program.

For example, when the discount rate is changed up or down by 0.5 percent, the approximate impact on the margin is +/- 10 percent.

Scenario Description	Margin
Base Case	19.66%
Discount rate increased by 0.5% to 6.25%	29.77%
Discount rate decreased by 0.5% to 5.25%	9.07%

During fiscal year 2012-13 the LTC Fund's actual investment return was 3.4 percent. The investment income was less than expected, therefore resulting in a decrease to the margin.

The conversion rate for participants eligible to make an election in 2013 was 28 percent, which was higher than the percentage assumed during the premium increase determination. This higher-than-expected conversion resulted in an improvement to the margin. However, because the actual conversion was not evenly distributed across all ages and was concentrated more in ages where fewer savings could be achieved, the impact to the margin is less than might be expected. The future conversion rate is expected to be consistent with the 2013 actual conversion rate.

As shown in the table below from Appendix C of the 2013 Actuarial Valuation, the changes in future conversion rates would result in an impact to the margin of +/- <1 percent.

Scenario Description	Margin
Base Case	19.66%
Higher Conversion rates	20.49%
Lower Conversion rates	18.87%

There are many variables, in addition to investment returns and policy conversions that can impact the margin such as policy lapse rates, morbidity and claims expenses. While the 2013 Valuation is encouraging, the experience should be measured against the assumptions over more than one year to judge the long-term stabilization of the program.

Going forward, impacted LTC participants will be given an opportunity for conversion to alternate plan options in 2014 to avoid the scheduled rate increases. That conversion data, post July 1, 2014, as well as, the 2014 Actuarial Valuation would be beneficial to make informed recommendations to the PHBC on further refinement to the Stabilization Plan.

Continued improvement in the margin of the LTC Fund could provide future options for Board consideration that might include decreasing the future 85 percent rate increase, changing the LTC Fund asset allocation, or enhancing benefits for current participants.

<u>Lower the 85 percent rate increase in 2015/16</u>
The LTC Program benefit plans that are currently 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 table is based on June 30, 2013, valuation data. It should be noted that participants with an open claim do not pay premium and are not affected by the rate increase, unless their claim is closed and they return to premium status.

		Subject to 85 Percent Increase		
Series	**Total**	**Active**	**On Claim**	**Total**
LTC1	120,441	82,893	3,874	86,767
LTC2	8,629	7,358	62	7,420

If the LTC margin remains stable, an option the Board might consider is lowering the 85 percent rate increase, which would lower the LTC Fund margin.

The following table illustrates a consistent five percent investment return and the resulting impact to the margin if the 2015/16 rate increase were reduced from the currently approved level.

Rate Increase	Margin
85%	3.58%
80%	1.89%
75%	0.14%
70%	-1.68%

<u>Changes to the asset allocation</u>
The current discount rate for the LTC Fund is 5.75 percent. Based on the 2012 LTC Insurance Valuation Survey done by Milliman, there has been a downward trend in interest rates in 2012 and the average interest rate used is 4.6 percent, ranging from 4 percent to 5.5 percent.

In April 2012, the Board adopted a more conservative asset allocation. LTC industry average for fixed income investments average 83 percent; compared to 73 percent in the CalPERS LTC portfolio. As shown on the chart on page 2, the margin of the LTC Fund is highly sensitive to investment returns. To reduce the risk of adverse outcomes resulting from investment volatility, the asset allocation could be more aligned to industry average.

<u>Changes to benefit design</u>
The PHBC may wish to consider benefit design changes for existing participants. One example would be to allow conversion from Facilities-Only to Comprehensive coverage. A growing number of participants are realizing the benefit of receiving in-home care and have asked the Program if such a policy conversion might be possible. Current practice requires participants to undergo underwriting for coverage increases.

The Facilities-Only product was priced using the actuarial assumption of “delayed claim,” in which the participant absorbs the cost of home care as long as possible and thus delays going into claim. Home care pays a lower monthly benefit – because home care benefit maximums are 50 percent for LTC1 and 70 percent for LTC2 and LTC3. While allowing the conversion to Comprehensive coverage would increase the participants’ premium, once the participant starts claim no premiums will be collected, which will result in lost premium. Allowing this conversion may also carry a higher morbidity risk due to the participant going into claim much earlier.

Participants wishing to purchase this policy upgrade would have a premium including the price of the new coverage at the current age and the price of the current coverage at the age when it was acquired. Additional analysis for any proposed benefit change is required to fully evaluate the potential impact such a change would have and ensure the long-term stability of the LTC Program.

BUDGET AND FISCAL IMPACTS

This agenda item has no budget or fiscal impact at this time. This item is for information purposes only.

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