Finance & Administration Committee

California Public Employees' Retirement System

Agenda Item 5a

October 14, 2014

ITEM NAME: Long-Term Care Valuation

PROGRAM: Actuarial

ITEM TYPE: Action

RECOMMENDATION

Approve the June 30, 2014, 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, 2014. 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 policyholders to move to a less expensive policy. The actuarial valuation also includes new policyholders that have purchased LTC policies since the reopening of the CalPERS LTC Program. This actuarial valuation includes 264 new policyholders.

The margin for the LTC program has continued to improve between 2013 and 2014. The margin as of June 30, 2014 is 23.5%, 3.8% higher than it was on June 30, 2013. The improvement in margin was mostly due to the investment performance in Fiscal Year 2013-2014. For further details on the reasons for the changes in margin, please refer to the Analysis section of this agenda item.

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 Program has 139,947 policyholders as of June 30, 2014. Information on the types of policies offered through the program and the number of policyholders under each type can be obtained in Appendix E in the valuation report attached to the agenda item.

The June 30, 2014, actuarial valuation was produced by United Health Actuarial Services, Inc. (UHAS).

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 policyholders 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 membership data and fund balance as of June 30, 2014. The funded status as of June 30, 2014, is 123 percent and the margin is 23.5 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, 2013, actuarial valuation.

Component	6/30/2014 ($ in Millions)	6/30/2013 ($ in Millions)
1. Present Value of Future Benefits	$6,223	$6,110
2. Present Value of Future Expenses	$381	$353
3. Present Value of Future Premiums (PVFP)	$3,251	$3,455
4. Valuation Liabilities (= 1 + 2 - 3)	$3,353	$3,008
5. Valuation Assets	$4,117	$3,687
6. Valuation Margin (= 5 - 4)	$764	$679
7. Margin as a % of PVFP (= 6 / 3)	23.5%	19.7%
8. Funded Status (= 5 / 4)	123%	123%

Even though the margin for the LTC Program is 23.5 percent as of June 30, 2014, it is important to remember that there are many variations in actual experience including investment return and morbidity that can easily cause the margin to decrease below the 10 percent target. For example, one year of negative investment return would significantly reduce the margin. 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 to 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

The margin of the LTC program improved by almost 4% percent between the 2013 and 2014 valuations. The main reason for the improvement in margin was the investment performance during the last fiscal year. The investment return for the assets of the LTC program was 10.6% in Fiscal Year 2013-14. This was almost 5% above the expected return of 5.75%. This resulted in an increase in the margin of about 5%.

The LTC program also saw an increase in margin as a result of better than anticipated experience resulting mostly from higher than expected policy conversions. As part of the Stabilization Plan that was approved by the Board, policyholders were given the opportunity to convert to less expensive policies. The elected conversion rate for the 2014 offer was about 15%, much higher than the 3% assumed in last year’s valuation.

As part of this valuation, a review of the actuarial assumptions was performed, including a review of the appropriate level of mortality improvements that should be used for the LTC program. Earlier this year, the CalPERS Board adopted new actuarial assumptions for the pension plans that included 20 years of mortality improvements for CalPERS pension members using the mortality improvement projection Scale BB. As part of this valuation, Scale BB was compared to recent life mortality studies and was found to be consistent with those results. Accordingly, Scale BB was used for future projections of mortality in this valuation. This new scale resulted in higher life expectancy than the previous improvement assumptions and resulted in a reduction to the margin and funded status. Note that contrary to the static 20 years of mortality improvements used for the pension mortality table, for the LTC mortality tables, generational mortality improvements were applied using Scale BB.

For LTC coverage, mortality improvements are usually associated with morbidity improvements. With the revisions to the mortality improvements, similar changes were applied to the morbidity improvements assumption which reduced the impact of the mortality change on the margin. Overall, the changes made to the actuarial assumptions resulted in a reduction in the margin of about 1%.

The table on the next page provides the breakdown of the reason for the improvement in margin between 2013 and 2014.

	Results as a Present-Value of Premiums
Margin as of June 30, 2013:	19.66%
Demographic experience gain	0.76%
Investment gain for FY 2013-14	5.02%
Revised assumptions	(0.96%)
Other	(0.99%)
Margin as of June 30, 2014:	23.49%

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 Long-Term Care Program for the last 5 years.

5 Year History of Funded Status and Margin

Valuation Date	Funded Status	Margin
June 30, 2010	97%	(2.98%)
June 30, 2011	127%	23.14%
June 30, 2012	96%	(4.66%)
June 30, 2013	123%	19.66%
June 30, 2014	123%	23.49%

BUDGET AND FISCAL IMPACTS

The June 30, 2014, actuarial valuation was prepared by UHAS. Last year, the valuation was prepared by internal actuarial staff. In late 2013, the actuary assigned to work on the LTC program left CalPERS to return to her previous employer. Left without an actuary and unable to hire someone over the last few months, the Actuarial Office hired UHAS to perform the actuarial valuation of the LTC program. Additional funding will need to be secured as part of the mid-year budget process to cover the additional expenses incurred this fiscal year for not having the work performed by internal staff.

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.

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 to the "Risk Analysis" section of the 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 - Long-Term Care Actuarial Valuation as of June 30, 2014.

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