Agenda Item 6

November 18, 2014

ITEM NAME: Long-Term Care Program Valuation Implications

PROGRAM: CalPERS Long-Term Care Program

ITEM TYPE: Information

EXECUTIVE SUMMARY

This agenda item is to provide the Pension & Health Benefits Committee (PHBC) information on the California Public Employees' Retirement System (CalPERS) Long-Term Care (LTC) Program's Valuation, stabilization plan, LTC Fund margin, and the planned premium rate increase. This information is provided within the context of promoting program objectives of stability and sustainability, and where possible, compares the CalPERS LTC Program's strategic direction to industry benchmarks and best practices.

STRATEGIC PLAN

This agenda item supports Strategic Goal A of the 2014-16 CalPERS Business Plan to stabilize and sustain the LTC Program.

BACKGROUND

In February 2012, CalPERS staff presented a LTC market study to the PHBC which had been conducted by Oliver Wyman. This study reviewed the characteristics of the LTC insurance market over the past ten years to understand historical changes, current dynamics, and served as a benchmarking analysis. The study compared the CalPERS Program to commercial and publicly sponsored programs, and provided a general landscape of the LTC insurance marketplace. Additionally, the study provided CalPERS with a better understanding of the financial challenges facing the LTC insurance market.

Following this effort, the CalPERS Board of Administration (Board) took a series of actions to stabilize the CalPERS LTC Program which included investment allocation modifications, lowering the discount rate to 5.75 percent and a target date for ending the ongoing 5 percent rate increase.

In October 2012, the Board adopted the following actions for the LTC Program to continue the stabilization efforts and improve the LTC Fund margin:

- Stop the ongoing annual 5 percent rate increases by July, 2014;
- Implement a rate increase of 85 percent for specific LTC1 and LTC2 policies to be levied over a two-year period, beginning in 2015;
- Offer a 10-year LTC policy with Retained Inflation (RI);
- Extend the RI option to all policies with built-in inflation protection; and,
- Include an optional Daily Benefit Amount (DBA) purchase option for participant's who dropped their built-in inflation protection or decreased their DBA after the 2010 premium increase.

Assumptions from these stabilization efforts were built into the Fiscal Year (FY) 2012-13 valuation and improved the FY 2011-12 valuation margin from a negative 4.66 to a 19.66.

Beginning in 2013, LTC participants, subject to the annual 5 percent rate increase, as well as, the 2015-16, 85 percent rate increase, were offered the opportunity to convert their Lifetime with Inflation Protection policies to the 10, 6, and 3-year policies with a BIO. Prior to July 1, 2014, the date the ongoing 5 percent rate increases ended, over 19,000 eligible participants took advantage of the option to convert their policies and avoid all premium rate increases. These policy conversions, along with the other assumptions, were factored into the FY 2013-14 valuation and the margin improved to 23.49 percent.

With the progressing stabilization of the program, the CalPERS Board approved the reopening of the CalPERS LTC Program since it had achieved and sustained a 10 percent margin.

On July 1, 2015, the first half of an 85 percent rate increase will take effect for the following LTC Program benefit plans:

- 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

ANALYSIS

This agenda item provides the Committee with a report on the FY 2013-14 valuation. It also reviews the current fund margin, provides a Risk Based Capital (RBC) approach to assessing financial stability in the LTC Program and provides sensitivity analyses to demonstrate possible impacts to the fund in specific scenarios.

Attachment 1 shows the highlights of the FY 2013-14 valuation report. As illustrated in this attachment, the LTC Program's margin is 23.49 percent, 13.49 percent in excess of the Board approved 10 percent margin requirement. The positive margin of 23.49 percent results from a combination of higher than expected investment returns, the lower discount rate of 5.75 percent, the 2014 rate increase of 5 percent, the projected FY 2015-16 rate increases, and anticipated policy conversions.

Even though the margin has increased from FY 2012-13 by 3.83 percent, the funded status of the LTC Program remains at 123 percent.

The table below provides the Committee with 2010-2013 historical LTC Fund margins, RBC ratios and discount rates. The CalPERS RBC is provided in the table for comparison to LTC insurance carriers' RBC ratios. It is noted that the other carriers' RBC ratios are not yet available for 2014. It should also be noted that CalPERS differs from these carriers who have the ability to spread LTC program risk over multiple product lines.

RBC Ratios and Margins / (Deficits) by Year					
Company	**2010**	**2011**	**2012**	**2013**	**2014**
Prudential	10.66	9.82	9.13	9.12	
Mass Mutual	10.14	10.45	10.07	9.08	
Mutual of Omaha	9.72	8.45	8.46	9.19	
Northwestern	9.06	9.35	10.73	8.59	
NY Life	9.05	10.11	10.43	11.21	
State Farm	8.53	8.97	9.02	9.19	
Transamerica	8.03	9.14	9.96	9.15	
Genworth	7.77	8.10	8.61	9.73	
John Hancock	7.72	8.69	8.30	8.60	
Bankers	5.67	6.03	6.79	7.64	
CalPERS LTC Program RBC Ratio	(0.49)	2.78	(0.65)	6.31	4.78
CalPERS LTC Program Margins/(Deficits)	(2.98%)	23.14%	(4.66%)	19.66%	23.49%
CalPERS LTC Program Discount Rate(s)	6.38%	*6.25%	5.75%	5.75%	5.75%

*For years 1-10, rate was 6.25%; For years 11+, rate was 7.6%

As illustrated in the table, the CalPERS LTC Program's stability shows improvement, but also reflects the continued sensitivity of both the CalPERS margin and RBC ratio to the underlying valuation assumptions.

CalPERS staff were asked to bring back to the Board scenarios of how a lower 2015-16 cumulative premium increase might affect the margin. The table below shows the effects of lowering the 2015-16 premium increases, using the current Board approved discount rate of 5.75 percent and the impact on the margin and RBC ratio.

Base Case and Scenarios	**CalPERS Board Approved 5.75% Discount Rate**			
	Base Case	**Scenarios**		
2015 Rate Increase Percentage	36%	32%	29%	25%
2016 Rate Increase Percentage	36%	32%	29%	25%
Cumulative Rate Increase Percentage	**85%**	**74%**	**66%**	**56%**
Margin	23.49%	20.0%	15.0%	10.0%
RBC Ratio	4.78	4.07	3.16	2.05

Note: Rate Increase Scenarios Based on Reducing Margin Surplus With Conversion Assumptions from the June 30, 2014 2013-14 actuarial valuation.

Using the current 85 percent rate increase, the margin would remain consistent with the FY 2013-14 valuation at 23.49 percent and the RBC at 4.78. The additional scenarios above demonstrate the effects of reducing the LTC Fund margins to 20, 15 and 10 percent over the next two years and the resulting effect on the RBC and the decrease of the cumulative premium increase. Although, CalPERS is not subject to regulation by the Department of Insurance (DOI), as a point of reference, the DOI requires a minimum RBC level of 2 percent, and a level of at least 4.0 is an industry standard that most insurance companies maintain in order to withstand market volatility.

The Committee also requested staff to explore a new LTC 5 product offering of a comprehensive coverage plan with a 365-day elimination period. Staff reviewed two LTC industry plans available in California that each had a 365-day elimination period option. After analysis, we found the premium differential from the 90-day elimination period to the 365-day elimination period was 20 percent lower for one carrier and 30 percent for the other. The variation in price differential would be based on company experience and also the coverage provisions. According to the 2014 Broker World

LTC survey, policies with more than a 200-day elimination period represented 1.3 percent of the policies in 2012 and 1.1 percent of the policies in 2013.

For CalPERS, initial analysis suggests that a 15 percent premium discount on the LTC4 pricing is appropriate for the CalPERS LTC Program for a 365-day elimination period, which is based on CalPERS experience and coverage provisions. Further analysis is needed to validate this price differential.

BUDGET AND FISCAL IMPACTS
Not Applicable.

BENEFITS/RISKS
The Program continues to improve financially due to stabilization efforts. The benefits to reviewing additional scenarios for the premium rate increase will ensure that the Program is in alignment with LTC industry standards, and the continued pursuit of providing a viable, sustainable voluntary insurance benefit for eligible members. Nevertheless, due to the continuing evolution and the fluctuation of the LTC insurance market, change could negatively impact these stabilization efforts.

ATTACHMENTS
Attachment 1 – FY 2014-15 Valuation Highlights

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