Finance & Administration Committee

California Public Employees' Retirement System

Agenda Item 7a

November 17, 2015

ITEM NAME: Long-Term Care Valuation

PROGRAM: Actuarial

ITEM TYPE: Action

RECOMMENDATION

Approve the June 30, 2015, 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, 2015. 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 893 new policyholders.

The margin for the LTC Program has decreased from 23.49% as of June 30, 2014 to 14.44% as of June 30, 2015. The decrease in margin was mostly due to the investment performance in Fiscal Year 2014-2015. For further details on the reasons for the changes in margin, please refer to the Analysis section of this agenda item.

Even though the margin decreased from last year because of poor investment return in Fiscal Year 2014-15, the margin of 14.44% as of June 30, 2015 is still in excess of the Board approved 10% margin requirement. Therefore, we are not recommending any premium changes beyond the rate increases scheduled in the Stabilization Plan approved by the CalPERS Board in October 2012.

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 136,253 policyholders as of June 30, 2015. 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, 2015, actuarial valuation was produced by CalPERS actuarial staff.

Similar to LTC insurance providers, the CalPERS LTC Program has experienced worse than expected morbidity, higher than expected claims, lower than expected voluntary termination, 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, 2015. The funded status as of June 30, 2015, is 111% and the margin is 14.44%.

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, 2014, actuarial valuation.

Component	6/30/2015 ($ in Millions)	6/30/2014 ($ in Millions)
1. Present Value of Future Benefits	$6,144	$6,223
2. Present Value of Future Expenses	$388	$381
3. Present Value of Future Premiums (PVFP)	$2,868	$3,251
4. Valuation Liabilities (= 1 + 2 - 3)	$3,664	$3,353
5. Valuation Assets	$4,078	$4,117
6. Valuation Margin (= 5 - 4)	$414	$764
7. Margin as a % of PVFP (= 6 / 3)	14.44%	23.49%
8. Funded Status (= 5 / 4)	111%	123%

The margin for the LTC Program is 14.44% as of June 30, 2015. The change in margin can be caused by many variations in actual experience including investment return and morbidity. 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 losses due to worse than expected experience, or 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 22 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 decreased by about 9% percent between the 2014 and 2015 valuations. The main reason for the decrease in margin was the investment performance during the last fiscal year. The investment return for the LTC program was negative 0.93% in Fiscal Year 2014-15. This was almost 7% below the expected return of 5.75%. This resulted in a decrease in the margin of about 9.8%.

Based on emerging experience, the morbidity increased by 3% this year when compared to that of last year, and 1% increase in morbidity would cause a decrease in margin by 2%. As a result, the change in morbidity in 2015 lowered the margin by about 6%.

The LTC program saw an increase of 4.76% in margin mainly as a result of higher and favorable 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 actual 2014 and 2015 conversions turned out to be higher than that assumed in the 2014 valuation.

LTC1 Lifetime Inflation to 10-yr Benefit Increase Option		
	2014	2015
2014 Valuation Assumption	15.0%	10.0%
Actual Conversion	9.4%	19.5%

LTC2 Lifetime Inflation to 10-yr Benefit Increase Option		
	2014	2015
2014 Valuation Assumption	18.0%	3.0%
Actual Conversion	20.2%	27.2%

The table below provides the breakdown of the reasons for the decrease in margin between 2014 and 2015.

	Results as a Present-Value of Premiums
Margin as of June 30, 2014:	23.49%
Projected One Year Forward (Passage of Time)	2.10%
Demographic Experience Gain	4.76%
Investment Loss for FY 2014-15	(9.79%)
Morbidity Assumption Change	(6.15%)
Expenses Assumption Change	(0.09%)
Model Change	0.12%
Margin as of June 30, 2015:	14.44%

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, 2013, and 2015. 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, 2011	127%	23.14%
June 30, 2012	96%	(4.66%)
June 30, 2013	123%	19.66%
June 30, 2014	123%	23.49%
June 30, 2015	111%	14.44%

BUDGET AND FISCAL IMPACTS

The June 30, 2015, 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.

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 – Actuarial Valuation Report of the CalPERS Long-Term Care Program as of June 30, 2015.

FLORA XIAOGE HU
Senior Life Actuary
Actuarial Office

ALAN MILLIGAN
Chief Actuary