

# State of Wisconsin



## Local Income Continuation Insurance Plan

### Actuarial Review as of December 31, 2013

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# I. Overview

The purpose of this report is to summarize our review of the Local Income Continuation Insurance Plan. Included are a brief review of the Plan's experience during 2013, an estimate of the Plan's liability as of December 31, 2013, and an analysis of current funding levels.

In preparing this report, we have relied on claim information provided by Aetna and the Department of Employee Trust Funds ("ETF"). We have not audited this information, but have relied on it as submitted after making reasonableness checks as we deemed appropriate under the circumstances.

The results of this review indicate that the Local Income Continuation Insurance Plan (including supplemental benefits) is in a strong financial position, with assets of \$33.5 million and estimated liabilities of \$5.2 million. The asset balance does not include \$1.9 million in deferred market gains which will be smoothed in over the next four years. We note that the deferred market gains listed here and as used in our financial projections are draft amounts provided by ETF due to the timing of our reports and the finalization of the deferred amounts.

In 2013, plan assets increased by 6.7%, while estimated liabilities decreased 8.6%. This resulted in the plan's annual net fund balance increasing from 454% of liabilities in 2012 to 546% of liabilities in 2013. As a result of the continued positive funded status of the plan, we recommend contributions not be reinstated at this time.

The remainder of this report summarizes the review in more detail. A number of actuarial assumptions have been made in estimating the Plan's liability. These assumptions are described throughout the report and summarized in Exhibit 1.

## II. 2013 Experience Review

### Fund Balance

During 2013, the assets of the plan increased from \$31,431,619 to \$33,542,573. Total revenues were \$3,366,398 with paid claims and administrative expenses totaling \$1,387,694. These components are shown in the following table along with figures for the previous three years for comparison purposes. The Net Ending Asset Balance does not include \$1.9 million in deferred market gains which will be smoothed in over the next four years.

	2010	2011	2012	2013
<b>Beginning Asset Balance</b>	28,097,196	30,457,781	31,777,793	31,431,619
Closing Adjustments	(11,837)	(52,551)	(42,974)	132,250
<b>Adjusted Beginning Asset Balance</b>	<b>28,085,359</b>	<b>30,405,230</b>	<b>31,734,819</b>	<b>31,563,869</b>
<b>Revenues</b>				
Premium Contributions	1,898,818	1,926,819	318,695	0
Investment Earnings	1,374,714	462,901	660,559	3,366,398
<b>Total</b>	<b>3,273,533</b>	<b>2,389,720</b>	<b>979,254</b>	<b>3,366,398</b>
<b>Expenses</b>				
Paid Claims	764,408	890,905	1,122,840	1,250,198
Administrative Expenses	136,702	126,252	159,613	137,497
<b>Total</b>	<b>901,111</b>	<b>1,017,157</b>	<b>1,282,453</b>	<b>1,387,694</b>
<b>Net Income</b>	<b>2,372,422</b>	<b>1,372,563</b>	<b>(303,200)</b>	<b>1,978,704</b>
<b>Ending Asset Balance</b>	<b>30,457,781</b>	<b>31,777,793</b>	<b>31,431,619</b>	<b>33,542,573</b>
<b>Estimated Liability</b>	<b>3,992,238</b>	<b>4,882,791</b>	<b>5,676,212</b>	<b>5,190,856</b>
<b>Net Fund Balance</b>	<b>26,465,543</b>	<b>26,895,001</b>	<b>25,755,407</b>	<b>28,351,717</b>
<b>Investment Earnings/Mean Ending Balance</b>	<b>4.8%</b>	<b>1.5%</b>	<b>2.1%</b>	<b>10.9%</b>

The following table shows the number of open and closed claims by year incurred and the average net monthly benefit.

### Claims By Year of Incurral

Year Incurred	Open Claims		Closed Claims		All Claims*	
	Number	Average Benefit	Number	Average Benefit	Number	Average Benefit
2013	20	\$ 1,953	68	\$ 2,508	88	\$ 2,382
2012	12	1,120	29	1,931	41	1,694
2011	6	1,164	2	1,652	8	1,286
2010	6	1,404	3	1,366	9	1,391
2009	6	578	-	-	6	578
2008	1	482	1	1,619	2	1,050
2007	-	-	-	-	-	-
2006	2	524	-	-	2	524
2005	6	334	-	-	6	334
2004	5	859	-	-	5	859
2003	3	1,467	-	-	3	1,467
2002	2	1,070	-	-	2	1,070
2001	-	-	-	-	-	-
2000	2	489	-	-	2	489
1999	-	-	-	-	-	-
1998	-	-	-	-	-	-
1997	1	992	-	-	1	992
1996	-	-	1	163	1	163
<b>Total</b>	<b>72</b>	<b>\$ 1,218</b>	<b>104</b>	<b>\$ 2,267</b>	<b>176</b>	<b>\$ 1,838</b>

\* Includes incurred claims which remain open as of 12/31/2013 and claims closing during 2013; does not include incurred claims closed in prior years.

The following table shows the claim count and average net benefit amount for open, closed and total claims, respectively, as of December 31, 2013, and each of the nine prior plan year ends. There was one claim incurred in 2011 which showed up as cancelled in the 2012 plan year dataset. This claim is included in the plan year 2012 'All Claims' columns below.

### Claims By Valuation Date

Plan Year	Open Claims		Closed Claims		All Claims	
	Number	Average Net Benefit	Number	Average Net Benefit	Number	Average Net Benefit
2013	72	\$ 1,218	104	\$ 2,267	176	\$ 1,838
2012	64	1,581	71	2,255	136	1,924
2011	60	1,356	79	2,247	139	1,862
2010	50	1,355	74	2,098	124	1,798
2009	58	1,451	52	2,277	110	1,842
2008	50	1,319	64	2,377	114	1,913
2007	51	1,164	94	866	145	971
2006	62	1,183	62	1,170	124	1,176
2005	52	1,376	49	1,195	101	1,288
2004	37	1,368	47	1,798	84	1,609

# III. Estimated Liability as of December 31, 2013

The Plan's liability for outstanding claims under the Local Income Continuation Insurance program was estimated in two parts — reported claims and incurred but unreported claims. The following paragraphs summarize the method used and results.

## Reported Claims

Disabled life reserve factors were calculated using the 1987 Commissioner's Group Basic Disability table adjusted for the State of Wisconsin's own termination experience. These factors represent the present value of future payments, at 7.2% interest, to a disabled person with a monthly benefit of \$1.00. In 2010, the Employee Trust Funds Board reduced the investment return assumption relied upon by the Wisconsin Retirement System ("WRS") from 7.8% to 7.2%, which has since remained at 7.2%. For consistency, and at the direction of ETF personnel, the valuation interest rate is tied to the WRS valuation rate; therefore a 7.2% discount rate was used in the December 31, 2013, valuation. The factors are indexed by age at disablement, duration of disablement, and duration to the end of the benefit period.

Aetna provided a listing of those persons known to be disabled as of December 31, 2013. The age at disablement, duration of disability and benefit end date, based on the maximum allowable duration of benefits under the plan, was calculated for each individual. The appropriate factors were then multiplied by the amount of benefit for each disabled person. The results were summarized by year incurred and in total.

For disabilities that last over one year, an additional \$75 per month is included in the normal benefit amount for the purpose of defraying medical costs. This supplemental benefit was effective January 1, 2002, for all claims in pay status. A liability was added for those claims incurred in 2013 representing the probability that claims will continue beyond the first year and the present value of the additional benefit. The liability for the \$75 supplemental benefit is already included in the liability for claims over one year in duration.

## Incurred But Unreported Claims

In addition to those claims reported as of December 31, 2013, there presumably are other claims incurred prior to that date but which are not yet reported. The Plan's liability for long-term disability claims begins on the date an employee is disabled, even though the employee is not eligible for payments during the waiting period or has not yet filed a claim. Besides the waiting period, delays in the reporting and processing of claims normally occur. Thus, an estimate of the additional liability for claims incurred but not reported as of the valuation date is necessary.

We performed a historical recast analysis from the Plan's own experience to determine the sufficiency of our past IBNR methodology. As a result of the analysis performed in prior years, a fixed percentage of 15% of the reported liability was established based on the observed historical levels of IBNR claims as a percent of the reported claim liability within the recast analysis. We performed a similar analysis this year and the results indicated that the established IBNR is sufficient and therefore the IBNR factor remained at 15% of the actuarial present value of claims in payment status. We will continue to monitor the effectiveness of the 15% factor over time and make adjustments as needed.

## Results

The total estimated liability as of December 31, 2013, for the Local Income Continuation Insurance program is \$5,190,856, developed as follows:

Reported Claim Liability	\$4,476,066
<u>\$75 Supplement</u>	<u>37,722</u>
Total Reported Liability	4,513,788
<u>Incurred But Not Reported Liability</u>	<u>677,068</u>
Total Liability	\$5,190,856

When compared to their respective liabilities as of December 31, 2012, the December 31, 2013, total reported claim liability and the incurred but not reported liability decreased 8.6%, resulting in an 8.6% decrease in the total liability. The decrease in the reported liability is largely due to the effect of a 23.0% decrease in the average net benefit per open claim, tempered by a 12.5% increase in the count of open claims. The decrease in the average net benefit was driven by an increase in the gross benefit offsets present in the 2013 incurred open claim cohort when compared to the 2012 incurred open claim cohort from the prior year dataset. The average offset amount can vary from year to year due to a change in the composition and characteristics of the average claimant in the open claim cohort. As the incurred but not reported liability is a fixed percentage of the reported claim liability, the decrease in the incurred but not reported liability is consistent with the decrease in the reported claim liability.

Exhibit 2 contains a breakdown of the \$4,513,788 reported liability by year of disability.

## IV. Analysis of Funding Levels

The Local Income Continuation Insurance Plan continues to be in a strong financial position with assets of \$33,542,573 and estimated liabilities of \$5,190,856 which produces a net fund balance of \$28,351,717.

A reasonable long-term objective would be to maintain a net fund balance of more than 100% of the estimated liabilities as a hedge against future adverse experience. Substantial year-to-year fluctuations can occur under disability income programs, particularly for the relatively small size of this program.

Maintaining a large funding balance in excess of estimated liabilities, perhaps 200% in excess, is prudent.

The excess now represents 546% of the estimated liabilities. The following table shows the net fund balance as a percentage of the estimated liability by year. The table demonstrates the fluctuating, although consistently sufficient, excess funding from year to year.

	2008	2009	2010	2011	2012	2013
<b>Assets</b>	25,871,414	28,097,196	30,457,781	31,777,793	31,431,619	33,542,573
<b>Estimated Liability</b>	3,886,827	3,840,102	3,992,238	4,882,791	5,676,212	5,190,856
<b>Net Fund Balance</b>	21,984,587	24,257,094	26,465,543	26,895,001	25,755,407	28,351,717
<b>Percentage</b>	566%	632%	663%	551%	454%	546%

The employer's premium contribution rate was reduced from .375% of covered payroll to .25% effective March 1, 2002. Effective 2012, all premium contributions were indefinitely waived. The \$75 Supplemental Add-on benefit was effective January 1, 2002.

Historically, the investment earnings of the plan have been large enough to fund the paid claims and administrative expenses of the plan. As a result, the assets of the plan continued to increase over time. In 2013 the investment earnings were greater than the paid claims and administrative expenses, resulting in a positive net income. Due to the continued large positive net fund balance of the plan, we are recommending a continuation of the waiver of premium. The necessity of future reinstatement will be based on the annual review of the plan's net fund balance relative to targeted funding levels.

## Exhibit 1

**Elimination Period** — 90 days average. Actual waiting period can vary between 30 and 180 days.

**Benefit Period** — The maximum duration of benefits for disabled insured employees is:

Age at Disablement	Maximum Duration of Benefits in Years
61 or Younger	To age 65
62	3.50 years
63	3.00 years
64	2.50 years
65	2.00 years
66	1.75 years
67	1.50 years
68	1.25 years
69	1.00 years

In no event are benefits payable beyond the 70th birthday.

**Termination Rates** — Deloitte Consulting completed a claim termination rate experience study using WRS disability program claims experience for claims incurred 5/13/2006 – 12/31/2010. The results of the claim termination rate study supported a reduction in the termination rate adjustment factor for the first and second year of disablement (from 280% and 260%, respectively). The percentage of the 1987 Commissioner's Basic Disability Table three month elimination period termination rates based on the State of Wisconsin's own experience are shown below:

Duration of Disablement	Termination Rate Adjustment
First Year	250%
Second Year	250%
Third Year	240%
Fourth Year	220%
Fifth Year	200%
Sixth Year	180%
Seventh Year	160%
Eighth Year	140%
Ninth Year	120%
Tenth Year & Later	100%

**Interest** — 7.2% per year.

**IBNR** — 15% of the liability for reported claims

**Contingency Margins** — None.

## Exhibit 2: Reported Claim Liability by Year of Disability

### Open Claims as of December 31, 2013<sup>1</sup>

Year of Disability	Count	Gross Benefit \$	Offset Amount \$	Net Benefit \$	Average Net Benefit \$	Estimated Base Liability	Estimated \$75 Supp Liability \$	Estimated Total Liability \$
2013	20	\$52,563	\$13,507	\$39,056	\$1,953	\$1,087,482	\$37,722	\$1,125,204
2012	12	34,400	20,955	13,445	1,120	680,808		680,808
2011	6	17,138	10,152	6,986	1,164	404,415		404,415
2010	6	18,450	10,026	8,424	1,404	643,852		643,852
2009	6	21,888	18,417	3,471	578	319,227		319,227
2008	1	3,013	2,531	482	482	4,062		4,062
2006	2	5,150	4,101	1,049	524	109,449		109,449
2005	6	13,450	11,443	2,007	334	111,777		111,777
2004	5	12,375	8,079	4,297	859	358,869		358,869
2003	3	10,049	5,646	4,402	1,467	434,927		434,927
2002	2	3,150	1,010	2,140	1,070	127,178		127,178
2000	2	4,275	3,297	978	489	99,559		99,559
1997	1	1,942	950	992	992	94,461		94,461
<b>Total</b>	<b>72</b>	<b>\$197,840</b>	<b>\$110,112</b>	<b>\$87,728</b>	<b>\$1,218</b>	<b>\$4,476,066</b>	<b>\$37,722</b>	<b>\$4,513,788</b>

<sup>1</sup>Open Claims presented by year of disability. For certain disability years (e.g. 2007, 2001, 1999, etc.), no claims remained open as of December 31, 2013.



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