

The State of Wisconsin



State Income Continuation Insurance Plan Actuarial Review as of December 31, 2005

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I. Overview

The purpose of this report is to summarize our review of the State Income Continuation Insurance Plan. Included are a brief review of the Plan's experience during 2005, an estimate of the State's liability as of December 31, 2005, and an analysis of current funding levels.

In preparing this report, we have relied on claim information provided by Broadspire and the Department of Employee Trust Funds. We have not audited this information, but have relied on it as submitted after making reasonableness checks and corrections as we deemed appropriate under the circumstances. The reasonableness checks warranted additional review on a significant number of cases. These cases were reviewed, and any errors were corrected.

The results of this review indicate that the State Income Continuation Insurance program (including supplemental) has assets of \$62.5 million and estimated liabilities of \$63.4 million as of December 31, 2005. The asset balance does not include \$11.8 million in deferred market gains which will be smoothed over the next five years. The net fund balance is \$(0.9) million. This net fund balance represents approximately (1.5)% of liabilities. Traditionally, a long-term objective of maintaining a net fund balance of 15% to 25% of estimated liabilities has been considered reasonable.

Premiums were reinstated for this plan on August 1, 1996. These premiums should stabilize the funded status of the plan. The annual net fund balances were 15% in 2001, 13% in 2002, 17% in 2003, 10% in 2004, and (1.5)% in 2005. Recently, the funded status of the plan has deteriorated and is no longer in the targeted range. In order to rectify this, we recommend an increase in premium revenue of approximately 7%. This is discussed further in Section IV of this report (Page 7).

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

II. 2005 Experience Review

Fund Balance

During 2005, the fund balance decreased from \$64,107,888 to \$62,548,480. Investment earnings were \$3,986,175, with paid claims and administrative expenses totaling \$15,304,126. These components are shown in the following table along with figures for the previous three years for comparison purposes.

	2005	2004	2003	2002
Beginning Balance	64,107,888	64,035,892	62,699,536	62,727,574
Closing Adjustments	(18,654)	(190,862)	226,566	600,797
Adjusted Beginning Balance	64,089,234	63,845,030	62,926,102	63,328,371
Revenues				
Contributions	9,777,198	9,621,923	9,295,493	9,164,530
Investment Earnings	3,986,175	5,090,324	4,529,984	3,073,851
Total	13,763,373	14,712,247	13,825,478	12,238,381
Expenses				
Paid Claims	13,341,722	12,453,660	11,029,413	11,313,665
Administrative Expenses	1,962,404	1,995,729	1,686,275	1,553,552
Total	15,304,126	14,449,389	12,715,688	12,867,217
Net Income	(1,540,754)	262,858	1,109,790	(628,836)
Ending Balance	62,548,480	64,107,888	64,035,892	62,699,535
Investment Earnings/Mean Balance	6.5%	8.3%	7.4%	5.0%

As of December 31, 2005 there were 1,054 open claims. During 2005, 1,215 claims were closed. Total reported claims incurred during 2005 were 2,269. The following table shows the number of open and closed claims by year incurred and the average net monthly benefit.

Open Claims by Year of Incurral

Year Incurred	Open Claims		Closed Claims		All Claims	
	Number	Average Benefit	Number	Average Benefit	Number	Average Benefit
2005	369	1,833	773	963	1,142	1,244
2004	160	1,196	345	1,124	505	1,147
2003	93	900	37	1,403	130	1,043
2002	68	912	17	648	85	859
2001	50	821	14	781	64	812
2000	43	740	7	1,019	50	780
1999	32	853	3	408	35	814
1998	28	641	2	1,286	30	684
1997	26	564	5	300	31	521
1996	30	688	2	870	32	699
1995	29	656	3	305	32	623
1994	29	596	2	524	31	592
1993	15	548	1	374	16	537
1992	11	769	2	350	13	705
1991	13	1,101	1	2,255	14	1,183
1990	13	834	0	NA	13	834
1989	15	632	0	NA	15	632
1988 & Prior	45	697	1	483	46	692
Total	1,054	1,211	1,215	1,009	2,269	1,103

The number of open claims for 2005 increased compared to last year, as did the average benefit amount for these open claims. Closed claims, however, only saw a slight increase in 2005 while the average benefit decreased. The following table shows this comparison for the last few years.

Open Claims by Valuation Date

Valuation Year	Open Claims		Closed Claims		All Claims	
	Number	Average Benefit	Number	Average Benefit	Number	Average Benefit
2005	1,054	1,211	1,215	1,009	2,269	1,103
2004	972	1,168	1,205	1,042	2,177	1,098
2003	876	1,255	1,148	1,261	2,024	1,258
2002	895	1,042	1,086	1,012	1,981	1,025
2001	1,084	1,132	662	2,044	1,746	1,478
2000	809	1,078	1,246	1,465	2,055	1,313
1999	757	998	1,323	1,381	2,080	1,242
1998	855	1,040	1,501	1,339	2,356	1,231
1997	859	1,004	1,068	1,364	1,927	1,203
1996	839	1,036	1,283	1,281	2,122	1,184
1995	872	933	1,094	1,309	1,966	1,142
1994	893	932	1,097	1,241	1,990	1,102

III. Estimated Liability as of December 31, 2005

The State's liability for outstanding claims under the State 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's own termination experience. These factors represent the present value of future payments, at 7.8% interest, to a disabled person with a monthly benefit of \$100. The WRS valuation rate was reduced from 8% to 7.8% as of February 1, 2004. For consistency, we reduced the interest rate accordingly for the December 31, 2005 valuation. The factors are indexed by age at disablement, duration of disablement, and duration to the end of the benefit period.

Broadspire provided a listing of those persons known to be disabled as of December 31, 2005. The age at disablement, duration of disability, and duration to expiration 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, a supplement of \$75 per month is included in the normal benefit amount for the purpose of defraying medical costs. A liability was added for those claims incurring in 2005 representing the probability that claims will continue beyond the first year and the present value of the additional benefit. The liability for the \$75 supplement is already included in the liability for claims over one year.

The reported claims include a liability of \$330,000 on supplemental claims, which are calculated in the same manner as the base claims.

Incurred But Unreported Claims

In addition to those claims reported as of December 31, 2005, there presumably are other claims incurred prior to that date that are not as yet reported. The State'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. Thus, it is necessary to estimate the additional liability for claims incurred but not reported as of the valuation date.

Besides the waiting period, delays in the reporting and processing of claims normally occur. From the State's own experience, we observed that 25% of claims open and closed during the previous twelve months are unreported as of year end. Thus, the State's liability for claims incurred but not yet reported was calculated as the estimated number of incurred but not yet reported claims times an average benefit amount times an average disabled life reserve factor. This methodology has produced stable results over the past several years.

Results

The total estimated liability as of December 31, 2005 for the State Income Continuation Insurance program is \$63,417,059, developed as follows:

Reported Claim Liability	\$53,912,134
\$75 Supplement	532,803
Total Reported Liability	\$54,776,447
Incurred But Not Reported Liability	8,640,612
Total Liability	\$63,417,059

This total liability is 9% higher than the liability determined as of December 31, 2004 due in large part to an increase in the number of open claims, as well as a moderate increase in the average benefit.

IV. Analysis of Funding Levels

The State Income Continuation Insurance program has assets of \$62.5 million and estimated liabilities of \$63.4 million, producing a net fund balance of \$(0.9) million. Investment earnings covered 26% of paid claims and administrative expenses. The premiums cover 64%. Premiums plus earnings combined covered 90% of the paid claims and administrative expenses. Thus, cash flow in the trust was negative this year. We reviewed cumulative cash flows for plan years 2001 through 2005. It is (\$2,248,731).

Considerable year-to-year fluctuations can occur under disability income programs, even for a program as large as the State. Thus, it is prudent to maintain a fund balance in excess of estimated liabilities. A reasonable long-term objective has been to maintain a net fund balance of 15% to 25% of estimated liabilities as a hedge against future adverse experience. The current positive balance represents (1.5)% of liabilities as compared to 10% last year. This is no longer in the targeted range. Also, the cumulative cash flow to the fund for the past five years is negative. Based on these factors we recommend an increase in premium revenue of approximately 7%.

The current premiums and benefits increase linearly as an employee's pay increases up to \$4,000.00 per month. Then no additional premium is charged for payroll between \$4,000.00 and \$5,333.33 per month, even though benefit levels continue to increase. Benefits and premiums for payroll beyond \$5,333.33 come from the optional supplemental disability program. We recommend replacing this compressed premium band (\$4,000.00 to \$5,333.33) with premiums that increase at the same rate per \$100 as is applied below \$4,000.00. This will increase premium revenue by about 8%. The adequacy of this new premium level should be reviewed in 3 to 5 years.

Exhibit 1

Elimination Period — 90 days average. Actual waiting period varies with accumulated sick leave and for University faculty, the elimination period selected.

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 — Percentage of the 1987 Commissioner's Basic Disability Table three-month elimination period termination rates based on the State's own experience, as shown below:

Duration of Disablement	Termination Rate Adjustment
First Year	280%
Second Year	260%
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 — 7.8% per year

Contingency Margins — None

Exhibit 2

Reported Claim Liability by Year of Disability

Open Claims as of December 31, 2005						
Year of Disability	Number	Gross Benefit	Offset Amount	Net Benefit	Average Benefit	Estimated Liability
2005	369	767,252	90,859	676,393	1,833	16,228,733
2004	160	330,979	139,606	191,373	1,196	10,091,253
2003	93	198,897	115,226	83,671	900	5,327,553
2002	68	152,117	90,113	62,004	912	4,294,134
2001	50	103,542	62,510	41,031	821	2,984,975
2000	43	86,845	55,004	31,841	740	2,555,013
1999	32	70,120	42,840	27,281	853	2,147,934
1998	28	59,855	41,895	17,961	641	1,168,884
1997	26	53,695	39,039	14,656	564	895,513
1996	30	54,309	33,672	20,637	688	1,493,272
1995	29	55,542	36,529	19,013	656	1,197,536
1994	29	48,098	30,806	17,292	596	1,137,604
1993	15	23,457	15,238	8,219	548	590,693
1992	11	17,212	8,753	8,459	769	667,549
1991	13	21,104	6,796	14,308	1,101	1,160,774
1990	13	20,500	9,652	10,848	834	569,469
1989	15	20,985	11,505	9,480	632	587,018
1988	8	13,819	5,106	8,713	1,089	603,603
1987	5	6,380	3,140	3,240	648	174,050
1986	2	2,049	1,373	676	338	53,087
1985	1	2,675	889	1,786	1,786	72,012
1984	5	4,774	2,559	2,215	443	145,738
1983	2	2,153	431	1,722	861	147,111
1982	2	1,821	705	1,116	558	58,082
1980	1	727	308	419	419	34,672
1979	3	2,524	997	1,527	509	49,445
1972	1	474	0	474	474	9,230
Total	1,054	2,121,903	845,548	1,276,355	1,211	54,444,937



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