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Ms. Betty Wittmann
Manager, Optional Insurance Plans & Audits
Division of Insurance Services
Department of Employee Trust Funds
801 West Badger Road
Madison, WI 53702

Re: Assessment of Premium Increase for Optional Plan – EPIC Dental, Excess Medical Plan and Accidental Death and Dismemberment Plan

Dear Betty:

As requested by the State of Wisconsin Department of Employee Trust Funds we have reviewed the information submitted by the EPIC Life Insurance Company (EPIC) for the Dental, Excess Medical Plan and Accidental Death and Dismemberment (AD&D) plan. EPIC has underwritten this voluntary, payroll-deduction supplemental plan, offered to employees of the State of Wisconsin, since 1994. This plan is primarily a dental plan with over 90% of the claims paid for dental benefits.

EPIC is requesting an overall increase of 29.5% for non-annuitants and 23.9% increase for annuitants. The majority of the rate increase is attributable to an increase in benefits. Approximately 26% out of the 29.5% (or roughly 88%) of the non-annuitant increase is due to an increase in dental benefits, whereas approximately 3.5% is due to claim experience. Based on our analysis, we believe the proposal is reasonable and within the Group Insurance Board's guidelines. EPIC's rate increase due to benefit changes and trend are appropriate and within our expected thresholds. Additionally, EPIC is using a claims target loss ratio of 72% to develop their needed rate increase, which is calculated separately from the proposed benefit changes. Based on the lower premium levels (compared to full dental and medical coverage) and industry standard loss ratio guidelines, we believe that the 72% target loss ratio is reasonable for this type of coverage.

This memo summarizes our analysis of the proposed premium rates effective for the period January 1, 2009 through December 31, 2010. We received the following information from EPIC:

- 2009 Annual Enrollment and Utilization Statistics
- 2006-2009 Rate Comparison
- Actuarial Memorandum
- Benefit descriptions for each coverage
- Responses to questions regarding initial renewal proposal, including;

- Contract and claim data by month,
- Rate change impact separated by each of the plan’s assumptions (i.e., coverage type, trend, benefit change),
- Expense load components and percentage of premium, and
- Detail regarding the development of the AD&D premium development
- Revised proposed rates

Summary of EPIC’s Proposed Rates

The table below shows the current EPIC rates by coverage:

| | AD&D | Excess Medical | Dental | Current Rate |
|------------------------------|-----------------|-----------------------|---------------|---------------------|
| <u>Non-Annuitants</u> | | | | |
| single | \$0.15 | \$1.30 | \$11.45 | \$12.90 |
| employee + spouse | \$0.30 | \$2.60 | \$22.90 | \$25.80 |
| employee + child | \$0.30 | \$2.60 | \$22.90 | \$25.80 |
| family | \$0.45 | \$3.90 | \$34.35 | \$38.70 |
| <u>Annuitants</u> | | | | |
| single | \$0.19 | \$1.66 | \$15.00 | \$16.85 |
| employee + spouse | \$0.37 | \$3.33 | \$29.95 | \$33.65 |
| employee + child | \$0.45 | \$3.90 | \$34.65 | \$39.00 |
| family | \$0.54 | \$4.60 | \$41.26 | \$46.40 |

The following summarizes EPIC’s rating methodology, assumptions, and proposed changes by benefit coverage type.

Dental:

- **Proposed Benefit Change** – Currently the dental benefit consists of coverage for both “Major” and “Ortho” types of claims. The Major benefit has a \$200 deductible, followed by 50% coverage of the next \$1,500. The Ortho benefit is limited to a \$1,200 lifetime benefit. The proposed change would lower the deductible to \$75, followed by 50% coverage of the next \$2,000. There is no proposed change to the Ortho benefit.

Additionally, EPIC is planning on having an open enrollment for this plan and is proposing a special enrollment with tiered benefits. The special enrollment limits the plan paid amount to \$500 and \$750 during the 1st and the 2nd years respectively.

The impact of the proposed benefit changes is approximately 29% increase for both non-annuitants and non-annuitants. The following table shows the impact of the benefit change on the current dental portion of the rates.

| | Current Dental Rate | Benefit Rate Change | % Change |
|---------------------------|----------------------------|----------------------------|-----------------|
| <u>Non-Annuity</u> | | | |
| single | \$11.45 | \$3.35 | 29.3% |
| employee + spouse | \$22.90 | \$6.70 | 29.3% |
| employee + child | \$22.90 | \$6.70 | 29.3% |
| family | \$34.35 | \$10.05 | 29.3% |
| <u>Annuity</u> | | | |
| single | \$15.00 | \$4.30 | 28.7% |
| employee + spouse | \$29.95 | \$8.50 | 28.4% |
| employee + child | \$34.65 | \$9.19 | 26.5% |
| family | \$41.26 | \$11.75 | 28.5% |

- Rating methodology** – EPIC uses a loss ratio rating method to determine their proposed experience rate change, which accounts for past experience and does not include the impact of the proposed benefit changes. The calculated rate increase is determined by dividing a projected loss ratio by the target loss ratio (72%), which is shown in the table below. The projected loss ratio is the projected claims (most recent year of claim experience trended forward to the proposal period) divided by the most recent year of premium.

| DENTAL RATE INCREASE | | | |
|-----------------------------|-----------------------------|--------------------------|-------------------------------|
| | Projected Loss Ratio | Target Loss Ratio | Proposed Rate Increase |
| Non-Annuity | 77.6% | 72.0% | 7.76% |
| Annuity | 73.3% | 72.0% | 1.79% |
| Total Dental | 76.4% | 72.00% | 6.07% |

- Experience data** – EPIC used one year of claim and premium experience (CY 2007) in their rating.
- Assumptions** – To calculate the projected claims, EPIC multiplied the base experience claims by their dental trend assumption, annual trends of 3.49% for non-annuity and 4.19% for annuity. The trends assumptions used are based on 50% of past plan experience and 50% on the industry average trend.
- Overall Dental Increase** – The table below shows the combined impact of the experience rate increase and proposed benefit changes on the dental portion of the rates.

| | Current Dental Rate | Experience Rate Change | Benefit Rate Change | Final Rate | % Change |
|---------------------------|---------------------|------------------------|---------------------|------------|----------|
| <u>Non-Annuity</u> | | | | | |
| single | \$11.45 | \$0.85 | \$3.35 | \$15.65 | 36.7% |
| employee + spouse | \$22.90 | \$1.70 | \$6.70 | \$31.30 | 36.7% |
| employee + child | \$22.90 | \$1.70 | \$6.70 | \$31.30 | 36.7% |
| family | \$34.35 | \$2.55 | \$10.05 | \$46.95 | 36.7% |
| <u>Annuity</u> | | | | | |
| single | \$15.00 | \$0.25 | \$4.30 | \$19.55 | 30.3% |
| employee + spouse | \$29.95 | \$0.55 | \$8.50 | \$39.00 | 30.2% |
| employee + child | \$34.65 | \$0.60 | \$9.19 | \$44.44 | 28.3% |
| family | \$41.26 | \$0.75 | \$11.75 | \$53.76 | 30.3% |

AD&D:

- Proposed Benefit Change** – Currently the AD&D has a full employee benefit of \$5,000 and a partial benefit of \$2,500. EPIC is proposing to double the benefits to a full employee benefit of \$10,000 and a partial benefit of \$5,000 for non-annuitants only, no change to the annuitants AD&D benefit.
- Rating methodology** – Due to the volatility of the AD&D experience, EPIC prices the benefit at market rates for similar coverage. EPIC is proposing a decrease in the rate per thousand dollars of coverage per month from \$0.03 to \$0.02. EPIC typically charges somewhere between \$0.03 and \$0.06 per thousand on all other AD&D coverage they sell and pays \$0.02 per thousand on all reinsurance they purchase. The table below shows the impact on the AD&D portion of the total rate for the proposed benefit and rate per thousand changes.

| | Current AD&D Rate | Rate Per 1,000 Change | Benefit Rate Change | Final Rate | % Change |
|---------------------------|-------------------|-----------------------|---------------------|------------|----------|
| <u>Non-Annuity</u> | | | | | |
| single | \$0.15 | -\$0.05 | \$0.10 | \$0.20 | 33.3% |
| employee + spouse | \$0.30 | -\$0.10 | \$0.20 | \$0.40 | 33.3% |
| employee + child | \$0.30 | -\$0.10 | \$0.20 | \$0.40 | 33.3% |
| family | \$0.45 | -\$0.15 | \$0.30 | \$0.60 | 33.3% |
| <u>Annuity</u> | | | | | |
| single | \$0.19 | \$0.00 | \$0.00 | \$0.19 | 0.0% |
| employee + spouse | \$0.37 | \$0.00 | \$0.00 | \$0.37 | 0.0% |
| employee + child | \$0.45 | \$0.00 | \$0.00 | \$0.45 | 0.0% |
| family | \$0.54 | \$0.00 | \$0.00 | \$0.54 | 0.0% |

Excess Medical:

- Proposed Benefit Change** – The excess medical benefit pays up to \$250,000 (\$100,000 for annuitants) after a \$250 deductible (\$500 for family plans). EPIC is not proposing a benefit change for the excess medical coverage.
- Rating methodology** – Similar to Dental, EPIC used a loss ratio rating method to determine their proposed experience rate change. The calculated rate decrease is

determined by dividing a projected loss ratio by the target loss ratio (72%). Due to the volatility of the excess medical claims, EPIC used the highest loss ratio level over the past six years to determine the estimated premium needed to cover the selected claims at a 72% loss ratio. EPIC had indicated that continuation of a pure manual rating approach (giving the actuarial claims experience zero credibility) would result in no change in the rates. Giving the experience full credibility would indicate even larger rate decreases than what EPIC is proposing. EPIC's proposal represents giving the experience a partial credibility weighting.

- The estimated impact of this rating methodology results in a 30.8% decrease for non-annuitants (31.9% decrease for annuitants) on the Excess Medical portion of the rates. The table below shows the impact of the proposed rate change on the Excess Medical rates:

| | Current Excess Medical Rate | Experience Rate Change | % Change on Current Rates |
|------------------------------|-----------------------------|------------------------|---------------------------|
| <u>Non-Annuitants</u> | | | |
| single | \$1.30 | -\$0.40 | -30.8% |
| employee + spouse | \$2.60 | -\$0.80 | -30.8% |
| employee + child | \$2.60 | -\$0.80 | -30.8% |
| family | \$3.90 | -\$1.20 | -30.8% |
| <u>Annuitants</u> | | | |
| single | \$1.66 | -\$0.53 | -31.9% |
| employee + spouse | \$3.33 | -\$1.06 | -31.9% |
| employee + child | \$3.90 | -\$1.25 | -31.9% |
| family | \$4.60 | -\$1.47 | -31.9% |

Proposed rate increase:

As described above, EPIC is proposing rate changes due to both historical plan experience and benefit changes. The table below shows the impact of the rate changes due to experience, benefit changes, and the overall impact of the proposed rates.

| | Current Rate | Experience Rate Change | % Change on Current Rates | Benefit Rate Change | % Change on Current Rates | Final Proposed Rates | % Change on Current Rates |
|------------------------------|--------------|------------------------|---------------------------|---------------------|---------------------------|----------------------|---------------------------|
| <u>Non-Annuitants</u> | | | | | | | |
| single | \$12.90 | \$0.45 | 3.5% | \$3.40 | 26.4% | \$16.70 | 29.5% |
| employee + spouse | \$25.80 | \$0.90 | 3.5% | \$6.80 | 26.4% | \$33.40 | 29.5% |
| employee + child | \$25.80 | \$0.90 | 3.5% | \$6.80 | 26.4% | \$33.40 | 29.5% |
| family | \$38.70 | \$1.35 | 3.5% | \$10.20 | 26.4% | \$50.10 | 29.5% |
| <u>Annuitants</u> | | | | | | | |
| single | \$16.85 | -\$0.28 | -1.7% | \$4.30 | 25.5% | \$20.87 | 23.9% |
| employee + spouse | \$33.65 | -\$0.51 | -1.5% | \$8.50 | 25.3% | \$41.64 | 23.7% |
| employee + child | \$39.00 | -\$0.65 | -1.7% | \$9.19 | 23.6% | \$48.25 | 23.7% |
| family | \$46.40 | -\$0.72 | -1.5% | \$11.75 | 25.3% | \$57.43 | 23.8% |

Deloitte Consulting Analysis

Our analysis included reviewing the information received, validating the assumptions used, discussing proposed methodology and assumptions with EPIC, and confirming the proposed rate increase.

Dental:

- **Proposed Benefit Change** – We conducted an independent calculation of the proposed benefit changes. Based on our analysis, we estimated the benefit change alone would increase the dental rates by approximately 33% - 35%, excluding the impact of the addition of the special enrollment limitation. EPIC is assuming a 29% increase on the dental portion of the rates due to the proposed benefit changes. The addition of the special enrollment limitation may dampen the expected rate increase slightly. However, since EPIC will be holding open enrollment, we would anticipate that there would be some anti-selection for this type of supplemental benefit and the resulting impact on the addition of the enrollment limitations would be minimal.

Since EPIC's proposed rate increase due to the increase in dental benefits is below our expected range, and the addition of the special enrollment wouldn't put their proposed increase outside our expected range, we believe that the proposed benefit change and rate increase is reasonable.

- **Trend** – EPIC proposed the following trends for each of the dental options:
 - Non-Annuityants – 3.49%, and
 - Annuityants – 4.19%.

In our experience, we have typically seen annual dental trends in the range of 4% – 7%. EPIC's trend rates are at the low end of this range and appear reasonable.

- **Target Loss Ratio** – The target loss ratio used to determine the experience rate increase for the dental coverage is 72%. The most recent year of experience for this plan has the following claims loss ratios:

Experience period loss ratio:

- Non-Annuityants – 71%
- Annuityants – 66%, and
- Total – 70%

The most recent year of claims is trended forward 2.5 years (midpoint of experience period, 7/1/07 to the midpoint of proposal period, 1/1/10) at the trend rates mentioned above. After applying trend, EPIC calculated the following projected claims loss ratios:

Projected loss ratio:

- Non-Annuitants – 77.6%
- Annuitants – 73.3%, and
- Total – 76.4%

The experience rate increase is then calculated by taking the projected loss ratio over the target loss ratio of 72%. The dental coverage is a supplemental plan which has lower premiums than a typical full dental and/or medical coverage. The expense load as a percent of premium typically increases as the amount of premium decreases. This is due to the fact that the cost for customer service, claims processing, and other expenses are not a direct correlation to the premium size. Currently, EPIC plan expenses for this plan are 30% of premium. Through research, we have seen industry and other state standard minimum loss ratios starting around 60% for individual health coverage and going even lower for limited benefit plans. Therefore, we believe that the 72% target loss ratio is reasonable.

AD&D:

As mentioned above, EPIC is proposing to double the benefit for only the non-annuitants. This proposed AD&D benefit for non-annuitants is priced at market rates. EPIC determined \$0.02 per thousand to be a reasonable rate to charge for the AD&D benefit change based on the fact that EPIC charges somewhere between \$0.03 and \$0.06 per thousand on all other AD&D coverage it sells. For the current AD&D benefit, EPIC is charging \$0.03 per thousand. Therefore, EPIC is proposing a rate per thousand decrease of 33% ($1 - 0.02/0.03$). The resulting rate impact of doubling the benefits and reducing the rate per thousand on the non-annuitant AD&D rates is a 33% rate increase. Note that the impact of the AD&D rate increase on the total proposed rate (dental, excess medical, and AD&D combined) is approximately 0.4%.

In our experience, we have typically seen a rate per thousand around \$0.02 - \$0.05 for this type of coverage. Since EPIC is proposing \$0.02 per thousand, which is actually a rate reduction, we believe that the rate per thousand is reasonable and meets a minimum 72% target loss ratio expectation. Additionally, due to the volatility, size (less than 1% of the premium and claims for this plan), and credibility we believe that EPIC's use of market rates, rather than plan experience, is reasonable. Also note that EPIC's proposal to double the non-annuitant benefits has minimal impact on the overall plan rate, approximately 0.4% rate increase.

Excess Medical:

EPIC used a target loss ratio of 72% to determine the experience rate increase for the Excess Medical. As mentioned above, due to the volatility of the Excess Medical claims, EPIC used the highest claim level over the past six years to determine the estimated premium needed to cover the selected claims at a 72% expected loss ratio. We believe that EPIC's approach of selecting the highest claim level over the past six years reasonably adjusts for the volatility of claims as well as addresses the issue that the Excess Medical loss ratio has been consistently low, ranging from 22% to 49%. We agree with EPIC that the Excess Medical loss ratio experience is not fully

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credible, while at the same time exhibiting at least partial credibility. We are comfortable that EPIC's use of the highest loss ratio experienced over the past six years as a basis for calculating the proposed rate decrease provides an appropriate degree of partial credibility waiting to the actual experience.

Summary

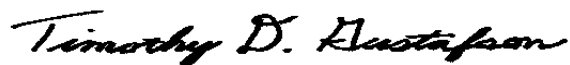
Dental: The proposed dental experience rate increase of 6.07% appropriately reflects the needed increase for a two-year rate based on the claims experience priced and a target loss ratio of 72%. The proposed dental benefit change lowers the deductible from \$200 to \$75 and increases the plan maximum from \$750 to \$1,000 for Major benefits. Additionally, EPIC is proposing to add a special enrollment benefit which limits the benefits for the first two years of enrollment. The proposed benefit increase due to the benefit change is consistent with our independent calculation.

Accidental Death and Dismemberment Plan: The proposed AD&D benefit change doubles the amount of benefit for non-annuitants but lowers the rate per thousand by 33%. These premiums are consistent with the market rates and appear reasonable.

Excess Medical: EPIC is not proposing any benefit changes for Excess Medical, but is decreasing rates to account for the favorable loss ratios over the past few years. We believe that the approximately 31% rate reduction due to the favorable experience is reasonable.

In summary, we believe the EPIC proposal for each piece is reasonable and is in line with the Group Insurance Board's guidelines for optional benefit plans. The target loss ratio used, although below the 75% guideline, is reasonable due to the low average premiums for this plan and industry standard loss ratio minimums for this type of plan are usually 60% or lower. It is our recommendation that ETF approve these changes due to the factors cited above. It is our understanding that the UW Board of Regents and the Office of State Employee Relations is responsible for negotiating with EPIC regarding the proposed premium rates, and that such negotiations were conducted with regard to these particular increases.

Sincerely,



Timothy D. Gustafson, FSA, MAAA

cc:

Bill Kox

Jeff Bogardus

Timothy FitzPatrick

Dawn Gross