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Correspondence Memorandum

Date: April 19, 2019

To: Group Insurance Board

From: Jim Guidry, Director
Benefit Services Bureau
Division of Retirement Services

Subject: Disability Programs Redesign Update

This memo is for information purposes only. No Board action is required.

This memorandum provides an update on the efforts to redesign the disability programs administered by the Department of Employee Trust Funds (ETF).

Contents

Background

The Department of Employee Trust Funds administers four disability programs under the authority of the Employee Trust Funds Board, Wisconsin Retirement Board (WR), Teacher's Retirement Board (TR), and Group Insurance Board (GIB). These programs are the 40.63 Disability Annuity (40.63), 40.65 Duty Disability (40.65), Long-Term Disability Insurance (LTDI), and Income Continuation Insurance (ICI) programs. These

Reviewed and approved by Matt Stohr, Administrator, Division of Retirement Services

Matt Stohr Electronically Signed 4/30/19

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programs combined for annual benefit payments of $240.8 million for 11,628 separate claims as of December 31, 2018[1]. The 40.63 program commands the largest share of disability payments with 60.0% of disability payments and 54.4% of all active claims (Exhibit 1).

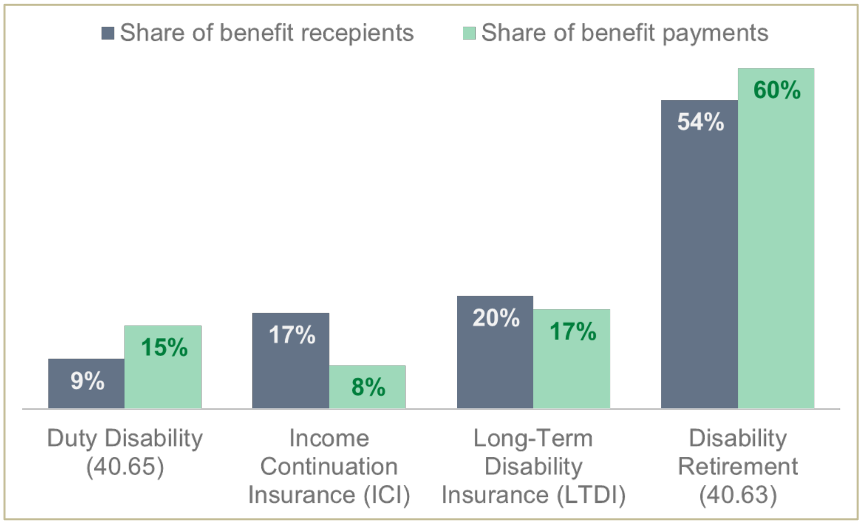

Exhibit 1. ETF Disability Programs

ETF evaluated the disability programs offered to State of Wisconsin and local government employees. The focus of this study was to evaluate possible options to redesign the disability benefit offerings in a way that was at a minimum cost-neutral, reduces duplication, and reduces complexity for employees, employers, and ETF.

This evaluation resulted in ETF's recommendation to update the disability programs and reduce the number of long-term disability options administered by ETF. The first phase of this project included a technical review of the voluntary Income Continuation Insurance (ICI) program plan language, which was completed in 2013.

The second phase of this evaluation was a review of the ICI and Long-Term Disability Insurance (LTDI) programs.

This evaluation resulted in a recommendation to close the LTDI program to new claims and reopen the 40.63 program. The Employee Trust Funds Board approved the closure of the LTDI program effective January 1, 2018, at its September 29, 2016, meeting. ETF obtained the necessary administrative rule changes in 2017 and the LTDI program was closed to new claims on January 1, 2018. ETF also took over the processing of payments of the remaining LTDI claims on February 1, 2018.

Concurrent with the closure of the LTDI program, the ETF Board approved changes to the 40.63 disability retirement program that would reopen the program to employees who were previously ineligible. This group included anyone hired after October 15,

[1] Some individuals may be receiving more than one WRS disability benefit.

1992, or anyone employed on or before that date with a break in service. This change also occurred on January 1, 2018. Currently, the ICI program and the 40.63 Disability Retirement program are the available long-term disability programs for WRS participants.

The second phase of the disability program review also included an assessment of the status of the ICI program. ETF's disability actuaries, Milliman, Inc. (Milliman), conducted an experience study of the state ICI program and presented options for redesigning the program and the impact of those changes on claim payments, premiums, and the state ICI deficit.

ETF proposed to streamline the state and local ICI benefit programs in order to reduce variation between the programs, increase enrollment in the state ICI plan, and eliminate the state ICI program actuarial deficit. This proposal reflected the disability programs redesign goals of cost neutrality, increased efficiency, reduced program duplication, and reduced complexity.

The state ICI program has been operating with an actuarial deficit since 2006. This deficit has grown substantially since 2008 due to various factors, which include declining enrollment and growth in long-term disability claims payments. The Group Insurance Board (GIB) has authorized numerous premium increases; however, premium growth has not been sufficient to eliminate the actuarial deficit up to this point. Continued premium increases, along with other external pressures, may be eroding enrollment in the program.

The local ICI program, on the other hand, has experienced outstanding performance results. The local ICI program is self-sustaining, with investment income exceeding benefit payments. The local ICI program has been able to pay claims and grow its fund balance despite being on a premium holiday since 2012. At its February 8, 2017, meeting, the GIB approved the following recommendations for modifications to the ICI programs most of which apply to the state program:

- Eliminate long-term benefits by reducing the maximum benefit period to 18-months following the employee selected elimination period.
- Reduce the benefit to 70% of pre-disability earnings up to a maximum monthly benefit of $7,000 based on a maximum monthly salary of $10,000.
- Replace the current premium rate structure with elimination-period (EP) based premiums. EPs of 30, 60, 90, and 180 days were proposed.
- Employers will pay the entire premium for the longest EP (180 days) with employees paying the premium differential for electing a shorter EP.
- Elimination of the $75 long-term disability add-on.
- Elimination of supplemental coverage.
- Elimination of the one-year service requirement before UW faculty and academic staff are eligible for employer premium contributions.

- Reduce the earnings offset to 70% for employees who return to work part-time with their former employer.
- Eliminate the requirement to exhaust sick leave prior to receipt of benefits.
- Effective date for the new program is targeted for January 1, 2021.

Although removed from the ICI program, long-term disability benefits are still available for WRS members through the 40.63 Disability Annuity program.

The redesign of the ICI program will require changes to state statutes that govern premium calculations, benefit durations, and waiting periods. Legislative action was not obtained in the 2017-2018 legislative session. ETF proposed the ICI changes as a part of its 2019-2021 biennial budget request, but they were not included in the Governor's budget recommendation. ETF is continuing to pursue legislative options.

The effect of these changes will be a leaner, more streamlined program that will be less complicated to administer, encourage greater enrollment in ICI, address the growing actuarial liability, and result in premium savings for employees as well as being, at a minimum, cost-neutral for employers. These modifications will also reduce the number of duplicative disability benefits offered to Wisconsin Retirement System (WRS) employees, thus reducing complexity in the administration and coordination of benefits as well as reducing confusion for WRS members.

A summary timeline is presented below (Exhibit 2):

Activity	Date
ICI technical changes Approved by GIB (effective Jan 2014)	May 2013
ICI Experience Study completed	Nov 2015
Milliman ICI/LTDI design and funding analysis	Mar 2016
Milliman ICI redesign options analysis	Apr 2016
Milliman finalized redesign review	July 2016
ETF Bd approved proposed LTDI/40.63 admin rule changes	Sep 2016
ICI redesign proposal approved by GIB	Feb 2017
ETF Bd approves LTDI/40.63 admin rule changes	May 2017
Final LTDI/40.63 approved rule filed with LRB	Dec 2017
LTDI closed-40.63 reopened	Jan 2018
ETF assumes payment of LTDI claims runout	Feb 2018
ETF assumes LTDI annual benefit adjustments from Hartford	Apr 2018
ETF assumes LTDI individual supplemental contributions process	Jul 2018
ETF assumes remaining LTDI administrative functions	Jan 2019
ETF assumes annual LTDI supplemental contributions process	Jan 2019

Exhibit 2 – Disability Programs Redesign Timeline

Disability Retirement Annuity (40.63)

Disability annuities are issued under the authority of the TR and WR Boards and are available to all WRS employees who had at least one-half year of creditable service in five of the previous seven calendar years.

An individual is eligible to apply for 40.63 benefits until they reach normal retirement age, and benefits are paid for an annuitant's lifetime. An individual must be totally disabled by a mental or physical impairment, which is likely to be of a long-continued and indefinite duration. Protective occupation participants who are not totally disabled can qualify for 40.63 Special benefits if they have at least 15 years of accumulated service, are between 50 and 55 years old at the time the disability occurs, and their disability causes them to no longer be able to perform their protective occupation duties. 40.63 benefits are paid in the form of a disability annuity that is determined using a combination of an annuitant's creditable service and a period of assumed service up to the individual's normal retirement age. Disability annuities most resemble a regular WRS retirement annuity and include similar death benefits, depending on the annuity option selected. 40.63 benefits can be suspended if an annuitant has earned income above an established earnings limit ($15,702 for 2019, indexed annually).

Annual adjustments made to 40.63 benefits are based on the same core annuity and variable annuity dividend percentages as monthly WRS retirement annuities. LTDI benefit adjustments are based on the core annuity dividend only.
In 2018 total benefit payments for the 40.63 program were $144.6 million. This amount was a 3.07% increase in benefit payments from 2017 and a 1.04% increase in total benefit payments since 2009. Total benefit payments declined 13.6% from 2008 to 2013 but have increased 12.04% since then.

As of December 31, 2018, there were 6,324 annuitants receiving a benefit under 40.63. Total annuitants receiving a 40.63 benefit in 2018 increased 0.78% from the previous year and has increased 1.61% since 2009. The average monthly 40.63 benefit in 2018 was $1,905, an increase of 2.3% from 2017 and a decrease of 0.55% since 2009 (Exhibit 3).

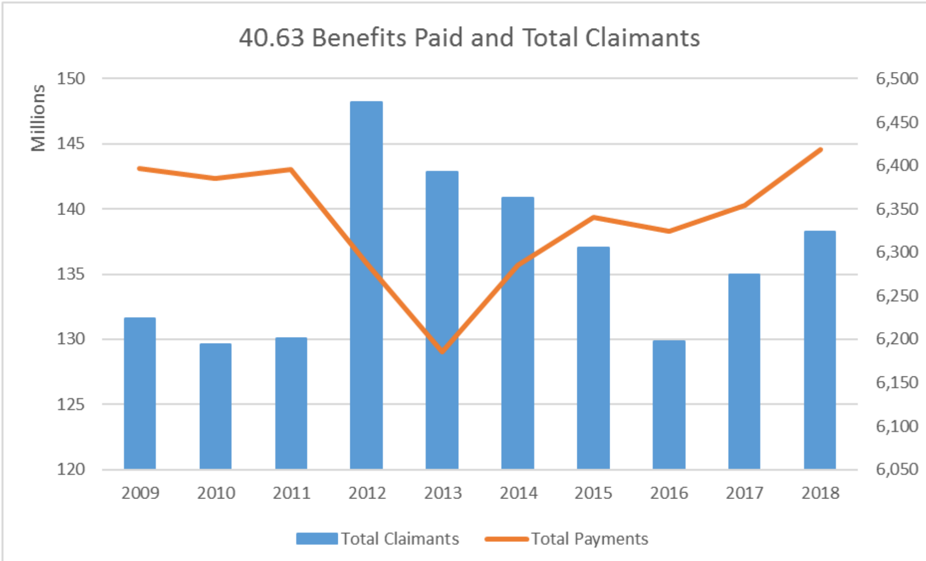

Exhibit 3. 40.63 Benefits Paid and Total Claimants

40.63 benefit payments and claimants have declined modestly since 2008, however with the closure of the LTDI program and the subsequent reopening of 40.63 on January 1, 2018, 40.63 benefits have begun to increase.

A total of 828 disability annuity estimates were completed in 2018, an increase of 105.4%. 40.63 disability annuity benefits that were started in 2018 totaled 245, a 155.21% increase over the previous year. Also, the program saw a 315% growth in new claims in 2018. These increases were anticipated and is in line with the projections made by ETF's disability actuaries. Additionally, the inventory of pending claims has increased from approximately 50 claims to more than 80 claims on average. Disability staff made improvements to benefit calculations in 2018 with the introduction of an automated calculation process. This change has enabled a 200% increase in the number of 40.63 benefit calculations performed in 2018. DRS is also working on increasing staff resources available to accommodate the large increase in 40.63 claims.

Duty Disability Benefits (40.65)

Duty Disability is an income replacement program that is available to all WRS protective occupation participants, such as police officers, fire fighters and correctional officers. This benefit is entirely funded by employer contributions. An individual must be permanently disabled by a work-related injury or disease and can no longer work full protective duty. There are approximately 22,000 active protective occupation participants in the WRS system and 6,700 inactive. [2,3] The 40.65 program is under the authority of the WR Board.

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[2] Inactive protective occupation participants are eligible for 40.65 benefits if they meet the eligibility criteria.

[3] All census information for 40.63, 40.65, and LTDI is from *Wisconsin Retirement System (WRS) 37th Annual Valuation of Active Lives and Gain/Loss Analysis – December 31, 2017.*

Duty Disability is not a retirement benefit. The benefit for 40.65 is calculated as a percentage of income, typically either 75% or 80%. Other sources of income, such as WRS benefits (retirement, separation, ICI, and LTDI), Social Security benefits, earned income, and Worker's Compensation benefits will reduce Duty Disability benefits. The 40.65 benefit is a lifetime benefit and is non-taxable. There may also be death benefits for surviving spouses and children.

The 40.65 program paid $35.5 million in benefits in 2018, a 1.14% increase from 2017 and an increase of 20.67% since 2009. The number of members receiving a 40.65 benefit was 1,022 as of December 31, 2018, which is an increase of 1.09% from the previous year and an increase of 8.96% since 2009. The 2018 average monthly benefit payment for 40.65 was $2,896, an increase of 0.06% from 2017 and an increase of 10.75% from 2009 (Exhibit 4).

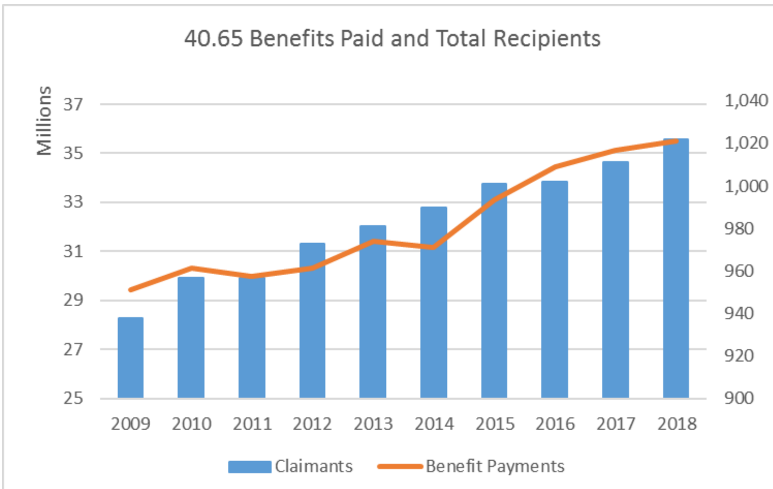

Exhibit 4 - 40.65 Benefits Paid and Total Recipients

Long-Term Disability Insurance

LTDI was created in 1992 as a result of the passage of the federal Older Workers Benefit Protection Act (OWBPA), which addressed age discrimination in employee benefits. The OWBPA raised concerns about the 40.63 program and whether it violated the Age Discrimination in Employment Act. LTDI was intended to eventually replace the 40.63 program. A review of recent U.S. Supreme Court decisions indicated that the 40.63 program did not present age discrimination issues for the state, and on September 29, 2016, the ETF Board approved the closure of the LTDI program.

The definition of disabled is the same as it is for the 40.63 program, and, like the 40.63 program, there are LTDI Special benefits for protective occupation employees who, although not totally disabled, are disabled from performing the duties of their position. LTDI benefits are payable to age 65 for most recipients. Depending on the individual's age when applying for LTDI, the benefit may be available beyond age 65. The basic monthly LTDI benefit is 40% of an employee's final average salary (FAS) or 50% for those ineligible for Social Security benefits. LTDI benefits are offset (reduced) by any WRS retirement or separation benefits the individual is receiving or is eligible to receive. Annual LTDI benefit adjustments are based on the core annuity dividend.

LTDI benefits will be suspended for exceeding the annual earnings limit the first time and will be terminated for exceeding the earnings limit a second time. LTDI Special benefits will not be terminated for exceeding the earnings limit, regardless of the number of occurrences. The earnings limit for LTDI benefits is the same limit used by the 40.63 program.

In addition to the basic LTDI benefit, a supplemental contribution of 7% of a claimant's final average salary is added to an employee's WRS retirement account for each month an LTDI benefit is received as long as no WRS retirement or separation benefit has been taken from the member's account. LTDI recipients who receive 40.65 benefits, exceed the annual earnings limit, or earn creditable service with a WRS employer are also ineligible for supplemental benefits.

Authority for the LTDI program was originally delegated to the GIB by the ETF Board. The ETF Board resumed oversight of the LTDI program beginning in 2017. This was done as part of the effort to consolidate the oversight of all disability programs under one governing board.

The LTDI program paid $42.2 million in benefits in 2018, a 6.4% increase from 2017 and an increase of 78.3% since 2009. The number of members receiving an LTDI benefit was 2,312 as of December 31, 2018, which is a decrease of 7.7% from the previous year and an increase of 66.5% since 2009. The 2018 average monthly benefit payment for LTDI was $1,521, an increase of 16.5% from 2017 and an increase of 7.1% from 2009 (Exhibit 5).

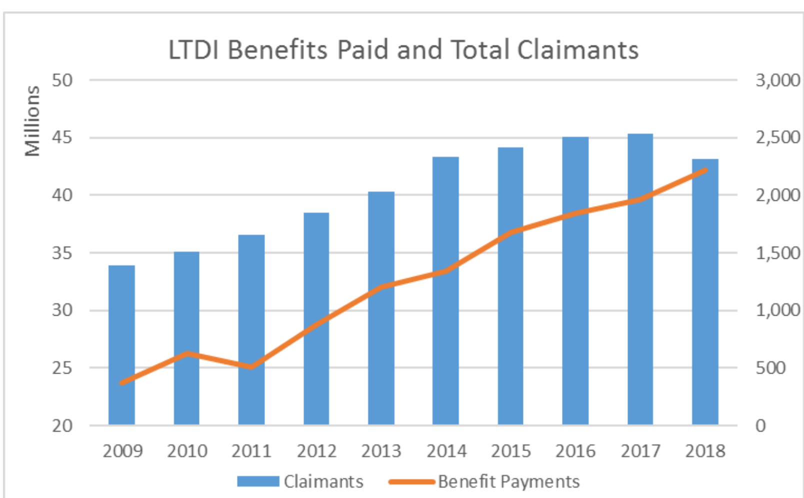

Exhibit 5 – LTDI Benefits Paid and Total Claimants

Prior to its closure, LTDI was available to all active WRS participants. The program closed to all new claims on January 1, 2018. There were 2,458 existing LTDI claims transferred to ETF from The Hartford. These claims will be run out to termination. The last remaining LTDI claim will reach its end date in 2054, assuming it does not terminate before then. Most LTDI claims, however, will terminate within the next 15 years.

There were 135 pending claims at the time that LTDI was closed. All of those claims have been processed. There are currently four open appeals of LTDI claim denials. Depending on the outcome of the appeal, these claims may be added to the LTDI payroll. There are currently 2,225 open and 12 suspended LTDI claims. The number of open and suspended LTDI claims declined 7.7% in 2018.

In April 2018, ETF took over the annual LTDI benefit adjustment process from The Hartford. In July 2018, ETF staff assumed the responsibility for completing all LTDI supplemental contributions to WRS accounts for eligible claimants. This includes annual contributions and individual “one-off” contributions prepared outside of the annual cycle. ETF completed the annual supplemental contribution process in January 2019, calculating 2018 WRS contributions for 2,041 LTDI recipients.

Also, in 2018 ETF completed the transition of all administrative functions relating to the LTDI program, including benefit payment offset calculations, LTDI recipient death processes, notifying certain recipients about the requirement to apply for a WRS benefit, tracking / suspending recipients due to exceeding the annual earnings limit, and claim closure processing.

Income Continuation Insurance

ICI is an optional disability income insurance benefit that provides replacement income for short-term and long-term disabilities. The program is a self-insured plan financed by employer and employee premium contributions. All state employers are required to participate, while participation is optional for local employers.

The ICI program will pay benefits to any insured individual who becomes disabled while employed by a WRS participating employer. ICI will pay 75% of average monthly earnings and offers Standard and Supplemental coverage:

- Standard Coverage – Covers up to $64,000 of annual earnings. The maximum benefit is $4,000 per month. Premiums are shared by employers and employees.

- Supplemental Coverage – Available to employees whose annual salary exceeds $64,000. Covers between $64,000 and $120,000 of annual earnings. The maximum benefit is $7,500 per month. Premiums are paid entirely by the employee.

The ICI benefit lasts until age 65 (with some exceptions), or until the employee is no longer disabled whichever is sooner. A $75 supplemental benefit is added to the normal monthly benefit amount when the benefit transitions to long-term ICI after one year. ICI benefits will begin after a state employee serves an elimination period or exhausts sick leave up to a maximum 130 working days, whichever is longer. All state employees (other than University of Wisconsin faculty and academic staff) have a 30-day elimination period. UW faculty and academic staff have an elimination period of 30, 90, 125 or 180 days.

Local employees, like UW faculty and academic staff, select their own elimination period, up to 180 calendar days. The local ICI plan does not require employees to exhaust sick leave prior to receiving benefits.

In the state ICI plan, premiums are determined by an employee's salary and amount of accumulated sick leave. The employee's accumulated sick leave level determines which of the six premium rate categories they fall into. ICI premiums for UW faculty and academic staff are determined by the employee-selected elimination period, as are premiums for local employees. Employer contributions to the state ICI program are based on percentages established in statute (§40.05 (5) Wis. Stat.). The employee share of the premium is determined by reducing the total premium by the employer share. The highest rate category, Category 6, is 100% paid by employers.

For UW faculty and academic staff and local employees, employers pay 100% of the premium for a 180-day elimination period. If an employee wishes to enroll with a shorter elimination period, they will pay the premium differential. Additionally, there is no employer contribution for UW faculty and academic staff until they have 12 months of state employment under the WRS.

ICI benefits continue until the recipient turns age 65 (with some exceptions), recovers, returns to full-time work, or dies, whichever occurs first.

ICI benefits will not duplicate certain benefits available from other sources, including the WRS, Social Security Administration, workers' compensation, and unemployment compensation. Duplicate benefit payments must be paid back to the ICI program.

The ICI program paid $18.5 million in benefits in 2018, a 7% decrease from 2017. The number of claimants receiving an ICI benefit (state or local) was approximately 1,221 as of December 31, 2018, which is a decrease of 5.6% from the previous year.

The ICI program is authorized by Wisconsin Statute §40.62 and is currently administered by The Hartford.

ICI Program Financial Condition

As of December 31, 2006, the actuarial valuation for the State ICI program highlighted a deficit of $6.3 million and a total liability of $67 million. By 2017, this deficit has grown 313% to $26 million, and the liability has risen 30% to $87 million (Exhibit 6). In order to counter the program deficit, ETF's actuaries recommended continued premium rate increases over the years (Exhibit 7). Significant rate increases of 20% annually from 2016 to 2020, which were projected to eliminate the program deficit by 2022, were proposed and approved at the May 2015 GIB meeting. The GIB has affirmed these increases each year since they were approved.

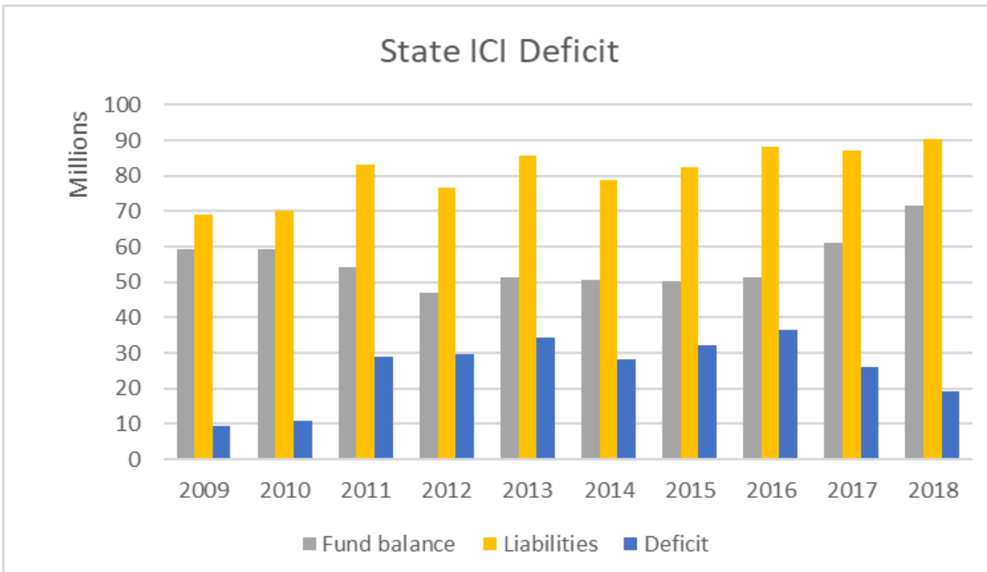

Exhibit 6 - State ICI Deficit Growth

The local ICI program has an actuarial surplus of $33.3 million as of the December 31, 2017 valuation. This surplus is significant when one considers that the local ICI program averages claim payments of approximately $1 to 1.3 million per year. The local program has been on a premium holiday since 2012 and is virtually self-sustaining as investment income has exceeded program expenses by at least $1 to $2 million annually since 2013.

Continued premium rate increases alone have not been able to eliminate the growing deficit in the state ICI program. Additionally, continuing increases could result in adverse selection and further escalate enrollment declines. In addition to premium increases for the state ICI program, Milliman has advised that program changes should be considered in order to stabilize the funding for the State ICI program over the long-term.

State ICI Premium Rate Increase History 2006-2019					
Actuary Report Year	**Plan Year (Ending 12/31/xxxx)**	**Premium Increases**			**Anticipated Future Increases**
		Effective Year	**Recommended**	**Board Approved**	
2006	2005	2007	7.0%	7.0%	N/A
2007	2006	2008	0.0%	0.0%	N/A
2008	2007	2009	0.0%	0.0%	N/A
2009	2008	2010	7.0%	7.0%	7% / 2012 & 2014
2010	2009	2011	0.0%	0.0%	7% / 2012 & 2014
2011	2010	2012	7.0%	7.0%	7% / 2014 & 2016
2012	2011	2013	0.0%	4.5%	9% / 2014 & 2016
2013	2012	2014	4.5%	4.5%	4% / 2015-2018
2014	2013	2015	7.0%	7.0%	7% / 2016 & 2017
2015	2014	2016	20%	20%	20%/2017-2020
2016	2015	2017	20%	20%	20%/2018-2020
2017	2016	2018	20%	20%	20%/2019-2020
2018	2017	2019	20%	20%	20%-2020

Exhibit 7-State ICI Premium Rate History 2006-2019

ICI Enrollment

The state ICI program has been experiencing declining enrollment since 2010 both in real numbers and as a percentage of total eligible employees (Exhibit 8). State ICI enrollment has declined 19% since 2010, while the number of WRS employees has increased 4%. In 2010, 68.4% of employees were enrolled in state ICI. The number of enrollees has fallen to 55.4% in 2018.

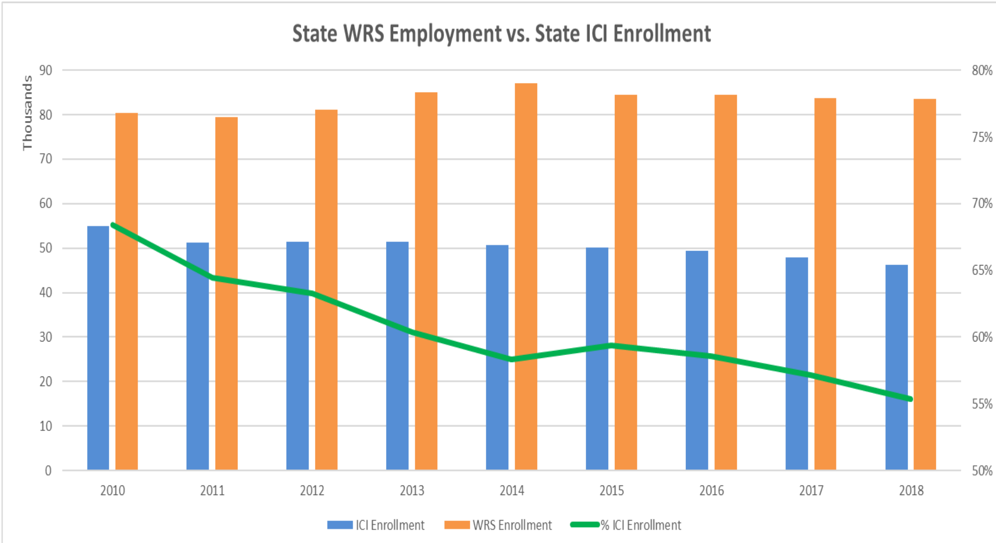

Exhibit 8 - State WRS Employment vs. State ICI Enrollment

ICI Long-Term Claim Growth

The state ICI plan has experienced growth in the number and benefits paid for long-term claims (Exhibit 9). Between 2009 and 2011, the number of long-term recipients averaged 100-200 more claims than short-term claims. In 2012, the gap between long-term and short-term claims began to increase and by the end of 2018 had risen to more than 400 claims.

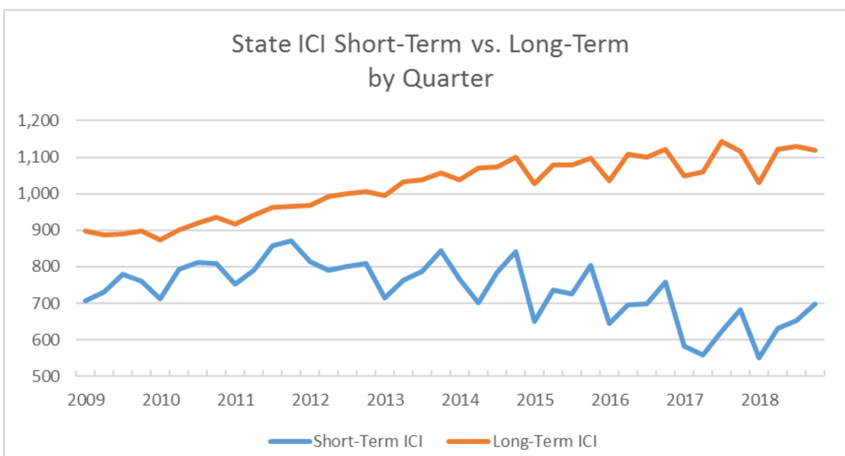

Exhibit 9 – State ICI Short-Term vs. Long-Term Claims by Quarter

Average monthly long-term ICI benefit payments tend to be smaller than short-term payments because long-term benefits are typically offset by other long-term disability benefits such as Social Security Disability Insurance (SSDI), LTDI, 40.65, and 40.63, in addition to income from other sources. However, due to the growth in long-term claims, the state ICI program is now paying out more in long-term benefits than short-term benefits (Exhibit 10) despite very little change in the difference between average short-term and long-term benefit amounts (Exhibit 11).

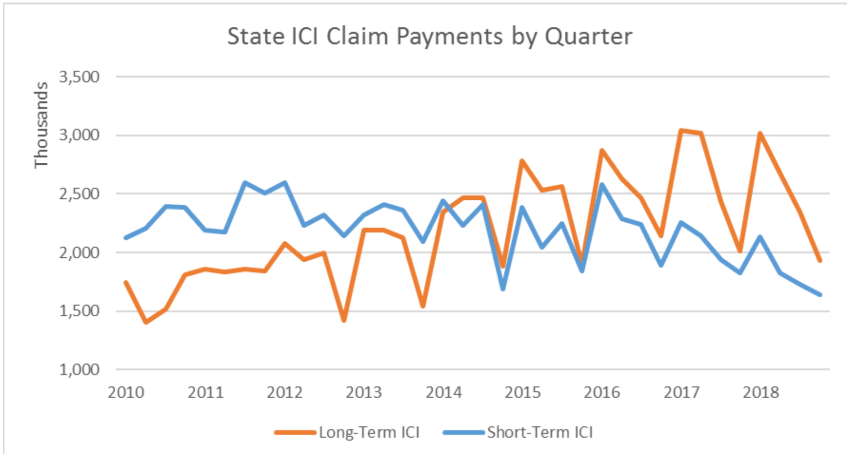

Exhibit 10 – State ICI Claim Payments by Quarter

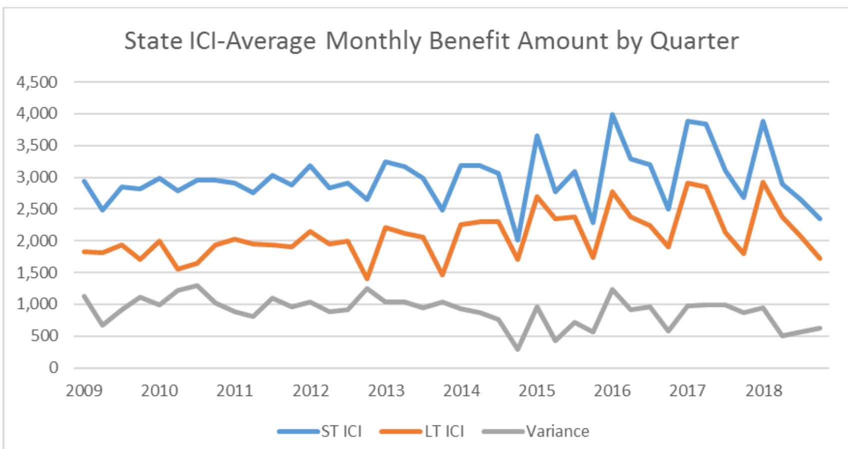

Exhibit 11 – State ICI-Average Monthly Benefit Amount by Quarter

ICI Program Evaluation

As part of its analysis Milliman conducted an experience study of the state ICI program in 2015 using premium and experience data from 2010-2014. This work confirmed that the current premium rates were not adequate for program funding. Milliman performed an interest adjusted loss ratio (IALR) analysis of the state ICI program and discovered that while the preferred IALR is 70-80%, only three state agencies met this target. The remaining agencies exceeded this target, one by a factor of eight. When Milliman examined state ICI experience by occupation, similar results were found, although some of these results were in occupations where it is expected that disability rates would be higher, such as protective occupations. Coincidentally, like the local ICI program, ICI premiums for UW faculty and academic staff are based on employee-selected elimination periods rather than accumulated sick leave.

The inadequacy of the ICI premium rates led Milliman to recommend, and the GIB to approve, successive 20% annual increases for the period of 2016 through 2020. However, these increases cause additional pressures on the state ICI program. Because of this, Milliman also recommended that ETF evaluate the possibility of making changes to the program itself.

The state ICI premium rates themselves are statutorily tied to an employee's accumulated sick leave balance. The premium structure is intended to encourage sick leave accumulation by reducing employee premiums after an employee reaches a certain level of sick leave accrual. The breakdown of the premium categories is shown in Exhibit 12.

Premium Categories 4-6 are classified as permanent categories. When an employee accumulates the required number of sick leave hours to enter into one of those categories, they will stay in that category (unless eligible to move to a higher category) even if their accumulated sick leave falls below the required threshold. Category 3 is a special category that allows employees to obtain a state contribution if they are able to accumulate 80 sick leave hours in a calendar year. Category 3 is not a permanent category.

Basing premiums on accumulated sick leave adds a degree of instability to the program, as sick leave levels fluctuate from year to year. It does not appear to be coincidental that the local ICI program, as well as the UW faculty and staff portion of the state ICI program have the best experience. This is likely owing to more stable risk exposure that comes from elimination period-based premiums.

State ICI Premium Categories	
Category	Sick Leave Accumulation
1	Less than 10 working days (80 hours) in the preceding calendar year and less than 23 working days (184 hours) total accumulation.
2	Less than 10 working days (80) hours in the preceding calendar year and 23 to 64 working days (184 to 520 hours) of total accumulation.
3	At least 10 working days (80 hours) in the preceding calendar year but less than 65 working days (520 hours) total accumulation. For purposes of this category only, one day equals 8 hours of sick leave for a full-time employee. For a part time employee, the daily equivalent shall be prorated as a percentage of full time, based on the employee's most recent appointment.
4	65 working days (520 hours) but less than 91 working days (728 hours) total accumulation.
5	91 working days (728 hours) through 130 working days (1040 hours) total accumulation.
6	More than 130 working days (1040 hours) total accumulated sick leave.

Exhibit 12 – State ICI Premium Categories

The decline in enrollment cannot be attributed to a specific cause. The ICI program is in the fourth year of consecutive 20% premium increases that began in 2016, and there is some indication that the actuarial deficit has started to improve. However, enrollment is still declining, and employers continue to relay to ETF that the premium increases are causing their employees to cancel coverage. Frequent increases in premiums can result in adverse selection, where only those employees most likely to use the benefit enroll in the program. This puts upward pressure on premium rates and cause more enrollees to exit this voluntary program.

Changes in the state's workforce also have implications for ICI enrollment. Beginning in 2010 many employees left the state workforce in above average numbers. These employees retired, for the most part, and were replaced by new employees with little to no accumulated service. From 2009 to 2017, the total number of active lives in the WRS system declined by 3.2% while, over the same period, the number of employees with up to four years of accumulated service increased by 12.5%. As a result of this shift, the percentage of employees with up to four years of accumulated service has risen from 28.8% of WRS active lives in 2009 to 33.5% in 2017 (Exhibit 13). This is important for the state ICI program because people with little accumulated service also have little accumulated sick leave and pay higher ICI premiums than employees with greater sick leave accumulation. This group of employees typically does not purchase ICI right away; instead, they wait until they qualify for Category 3, which offers a special reduced premium for employees and an employer contribution.

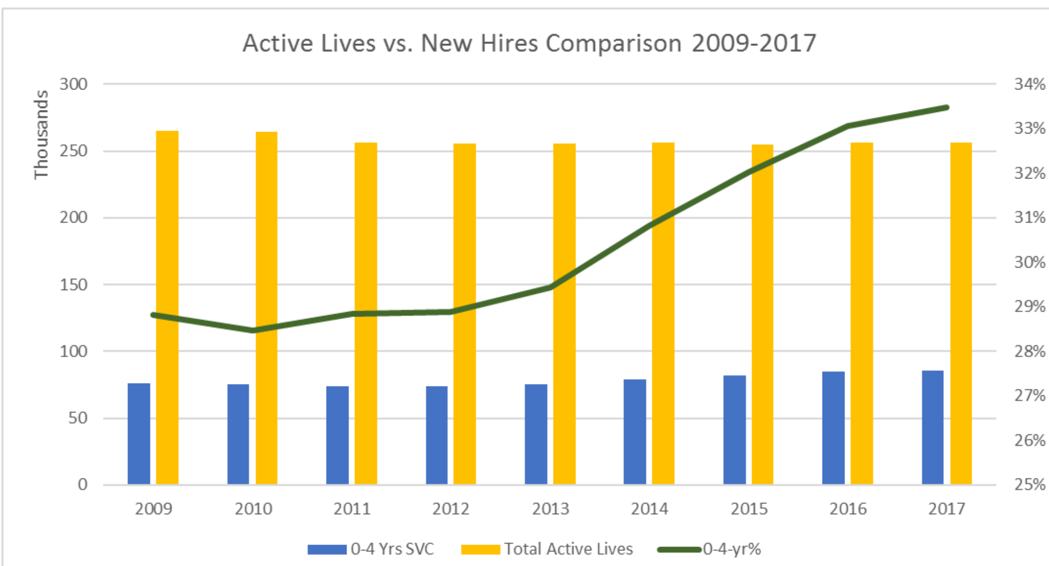

Exhibit 13 - Active Lives vs. New Hires Comparison 2009-2017

Over the same period (2009-2017), total state ICI enrollment declined 14%, while the number of state WRS employees grew 4.8%.

On a similar note, the number of employees aged under 30 has increased 12.3% and make up 11.1% of total active lives, up from 9.6% in 2009. This age group is another segment that typically does not enroll in ICI coverage (at least when initially hired) and could also be influencing the decline in enrollment. It is most likely a combination of all of these factors (premiums, workforce, and external financial pressures) that are contributing to the downward trend in ICI enrollment.

Another consideration is the generous level of the ICI benefit. ICI pays claimants 75% of average monthly earnings for both short-term and long-term benefits until a claimant reaches age 65, which, depending on the recipient's current age, can stretch decades into the future. Milliman indicates that 75% of monthly earnings is unusual, compared to industry standards, as is the additional long-term $75 monthly add-on benefit. Typical disability plans have benefit levels of 60%, with 65-70% benefit levels considered as "generous." Another point of consideration is that at 75%, a claimant can effectively meet or exceed their actual after-tax income, depending on the taxability of their ICI benefit. ICI benefits are taxable based on the level of employer contribution that occurs. Employees on a disability benefit who can match their take-home pay have less of an incentive to return to work.

The ICI program has multiple variations, including both short and long-term components, separate rules for University of Wisconsin faculty and academic staff, and a program for local employers with EPs that differ from the UW variant. These variations or "programs within the program" have different rules that cause confusion for employees, employers, the third-party administrator (TPA), and ETF staff alike. Since premium increases alone are not likely to solve the state ICI program's funding issues, the next logical option was a review of program structure. Using a holistic approach, changes to the ICI program were viewed in the context of all of ETF's disability benefit options and our redesign goals of reducing duplication and simplifying program administration.

ICI Program Redesign

After evaluating the analysis provided by Milliman, ETF developed a program structure that achieves the goals of the disability programs redesign project and addresses the financial and enrollment issues facing the state ICI program. The primary methods for achieving these objectives are decoupling sick leave from the state ICI program and converting ICI to a short-term disability benefit. A full list of the options selected by DRS to achieve the redesign goals follows.

Decouple sick leave from premium and effective date determinations:

- Eliminate state ICI premium rate categories based on accumulated sick leave and replace them with elimination period (EP) based premiums instead – 30, 60, 90, and 180 days. Employers will pay the entire premium for the 180-day EP and employees will "buy up" to a shorter elimination period if desired.
- Eliminate the requirement to exhaust sick leave before benefits can be paid in the state ICI program.

Eliminate long-term ICI benefits:

- Increase ICI benefit duration to 18 months after completion of employee-selected EP.
- Eliminate monthly $75 long-term add-on.

Other benefit changes:

- Reduce the benefit amount from 75% of salary to 70%.
- Eliminate supplemental coverage; increase the maximum monthly benefit for standard coverage to $7,000, which is 70% of $120,000 of annual earnings.
- Eliminate the requirement for UW employees to be employed 12 months before becoming eligible for state contributions to premium.
- Change return to work/rehabilitative income offset from 75% to 70%.

Decoupling sick leave from the state ICI program streamlines the ICI program by adopting provisions from the local ICI program and the UW portion of the state ICI program.

Decoupling sick leave, combined with eliminating supplemental coverage, also has the additional administrative effect of eliminating the annual deferred enrollment/supplemental enrollment periods in the ICI plan. Under the plan, state employers will no longer have to review their employee's sick leave balances for ICI premium category determinations at the end of each calendar year in order to determine the correct premium category each of their employees is eligible for. An employee will choose their EP during their initial enrollment. If an employee wishes to shorten their EP, they will be able to achieve this by filing an evidence of insurability application, which is the current procedure in the local ICI program. By eliminating these two elements, there will no longer be an annual enrollment process for employers or employees.

The elimination of long-term ICI benefits was proposed for three reasons. Primarily, the current structure of the state ICI program is not sustainable given the current level of premiums. On the other hand, increasing premiums by an amount sufficient to address the funding imbalance will likely add more downward pressure on enrollment, leading to adverse selection. The growth in long-term claims payments is likely to continue given the duration of long-term disability payments in the ICI program.

Eliminating long-term benefits will help address the deficit problems by providing greater certainty in premium development, due to the limited benefit period and set elimination periods rather than using accumulated sick-leave levels, which fluctuate from year to year.

Long-term ICI benefits were originally designed to provide continuity for disability claimants who were totally disabled, beyond short-term ICI. The approval process for other long-term disability benefits such as 40.63 and Social Security Disability Insurance can be time consuming. While ICI claimants are encouraged to apply for long-term disability benefits while they are still receiving short-term benefits, 12 months may not be enough time for them to get long-term benefits approved. By extending short-term benefits to 18 months, employees will be much less likely to find themselves in a

position of financial hardship if their long-term benefits are not approved prior to the current 12-month expiration period of their short-term benefit.
In addition to addressing the program deficit, reducing the benefit percentage from 75% to 70% is also intended to encourage employees to return to work. A 75% benefit is considered a rich benefit by industry standards and could result in a claimant earning more in disability benefits than their original take-home pay. This creates a tremendous disincentive to return to work. To further encourage disabled employees to return to part-time work, the plan also reduces the earnings offset from 75% to 70%.

The redesigned ICI plan eliminates supplemental coverage and increases the maximum annual earnings associated with the basic benefit to $120,000, the current maximum income limit for supplemental coverage. Eliminating supplemental coverage helps with administrative efficiency by contributing to the elimination of the annual enrollment process. Currently, eligible employees can enroll in supplemental coverage annually. However, this means that employers (including local employers) must identify and reach out to those employees eligible to enroll in supplemental coverage each year.

Analysis

Redesigning the ICI program significantly decreases the estimated incurred claim liability for the state ICI plan. The annual state ICI valuation dated April 10, 2018, projected a liability of approximately $168 million by the end of 2026. By changing to a redesigned plan that includes a benefit amount of 70% and an 18-month benefit duration, Milliman estimated that the incurred claim liability for the state ICI plan would be approximately $78.7 million in 2026.

Under the revised plan, individual premium levels will decline, due to the limitations on benefit duration and the reduction to a 70% benefit. These decreases occur even though the maximum income level was increased to $120,000. Employees will see the greatest premium impact, due to increased enrollment and changes to the employer contribution structure. Milliman estimated that the state ICI program enrollees could see potential decreases of $6.2 to $8.4 million in premiums paid for a redesigned program with a 70% benefit and 18-month benefit duration.

With these reductions, it is anticipated that the state ICI program will see substantial increases in enrollment. Under the current premium structure employees must accumulate sick leave before becoming eligible for an employer contribution. Under the redesigned plan, premiums and employer contributions are no longer dependent on sick leave accumulation. Instead, employees choose from one of four elimination periods, with the employer paying the entire premium for the lowest cost EP of 180 days. This shift is likely to provide incentive for any employee not participating in the ICI program to enroll in at least the 180-day EP because they can do so at no cost. The availability of employer-paid coverage for all members will improve the overall risk pool by reducing anti-selection, since many healthy members now decline coverage due to the growing out-of-pocket cost. There were approximately 37,275 people who are currently not

enrolled in the state ICI program as of December 31, 2018. Milliman's analysis assumes that all of these people will enroll in the redesigned program.
It is this substantial growth in enrollment that mitigates the amount of anticipated savings that employers will experience. Milliman estimated that under a 70% benefit level, employers will pay an additional $4.9 million in premiums to cover the influx of new enrollees. Also, those employees who are currently in ICI Categories 1 and 2, and pay 100% of the premium, will benefit from an employer match. Employers will pay a premium contribution of $1.9 million for those employees. These increases, however, are completely offset by substantial savings in the employer contributions for their employees in the remaining premium categories and under Milliman's most conservative projection overall employer contributions would decrease by $130,000.

It is important to note that while these structural changes will also occur to the local program, such as eliminating long-term benefits and changing EP's to match the state program, the local program will remain a separate program. However, the two programs will appear to be virtually identical. This is important on two aspects. First, syncing up the programs will greatly aid ease of administration, with only one set of rules to govern both plans. This reduces confusion and error. Secondly, ETF will benefit from having fewer program rules to incorporate into the future development of a new benefits administration system.

Next Steps

Modifying the ICI program structure and consolidating disability programs oversight under the ETF Board requires changes to statutes. ETF developed draft legislative changes to enable the redesign of the ICI program to occur. The legislation did not see action by the legislature before the 2017-2018 session was adjourned. The Governor's budget proposal, submitted on February 28, 2019, included the oversight changes requested by ETF, however, the ICI plan design changes were not included. ETF continues to pursue legislative support for the ICI redesign effort.

A substantial communication effort will need to occur so that all ETF stakeholders, including employers and employees, are aware of the changes and impacts. Additionally, a re-enrollment effort will need to occur to shift current enrollees from their existing rate category and into an EP of their choosing. Most program materials will need to be updated.

Once approved, benefit changes would go into effect January 1, 2021. ETF is also in the preliminary stages of developing a targeted reserve policy for the state and local ICI programs. This policy will guide the GIB (and the ETF Board once the ICI oversight changes are enacted) and the program actuaries in determining a reserve target to further assist in determining premiums relative to the desired fund balance. A similar policy is currently in development for the Duty Disability program. We anticipate presenting this policy proposal and reserve target recommendations to the November 13, 2019 GIB meeting.

ETF is also introducing changes to the Wisconsin Administrative Code that will remove obsolete language from the LTDI rules, as well as making technical changes to the Duty Disability rules. A hearing on the scope statement for that proposal was held on March 21, 2019.

In addition to the statutory requests mentioned above, ETF's budget request also included statutory changes to the 40.63 program to improve program administration. These changes include termination of benefits if a claimant exceeds the earnings limit twice in five years, eliminating the requirement to extend a member's last day paid for lump sum payouts at termination so that 40.63 benefits are calculated similarly to WRS retirement benefits, and allowing survivors of deceased applicants to choose between 40.63 program benefits or WRS death benefits if an applicant passes away prior to completing the claim approval process. These changes were not included in the Governor's budget request.

Staff will be at the Board meeting to answer any questions.