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The State of Wisconsin

WISCONSIN DEPARTMENT OF EMPLOYEE TRUST FUNDS

State Income Continuation Insurance Plan Actuarial Review as of December 31, 2008

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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 2008, an estimate of the State's liability as of December 31, 2008, 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 and recommended corrections to Aetna as we deemed appropriate under the circumstances.

The results of this review indicate that the State Income Continuation Insurance Plan (including supplemental benefits) has assets of $60.4 million and estimated liabilities of $72.8 million as of December 31, 2008. The asset balance does not include $13.1 million in deferred market losses which will be smoothed in over the next four years. The net fund balance is $(12.4) million. This net fund balance represents approximately (17.1)% 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 stabilized the funded status of the plan for a number of years. The annual net fund balances (as a percentage of liabilities) were 13% in 2002, 17% in 2003, 10% in 2004, (1.5)% in 2005, (9.4)% in 2006 and (4.3)% in 2007. Since 2005, the funded status of the plan has been deteriorating and has not been in the targeted range, despite an increase in premium revenue of approximately 7% that took effect February 1, 2007. Although the premium increase lead to a slight improvement in the net fund balance from 2006 to 2007, the improvement in the net fund balance was diminished throughout 2008, as the plan experienced a 12% increase in liabilities and poor asset yield experience (despite the plan showing positive investment earnings, $13.1 million in 2008 investment losses remain to be recognized in 2009 and later).

As a result of the worsening funded status of the plan and known, yet unrealized investment losses, we are recommending a 7.0% increase to plan premium to be implemented in 2010. Further, based on current financial projections, it is anticipated that additional 7% premium increases will be recommended in future years to be implemented in 2012 and 2014 in order to return the net fund balance to target levels over the longer term.

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. 2008 Experience Review

Fund Balance

During 2008, the fund balance decreased from $62,022,782 to $60,358,843; Total revenues were $14,166,024 with paid claims and administrative expenses totaling $16,549,706. As shown below, investment earnings dropped by approximately $5.2 million, resulting in a 23% decrease in total revenue. The 2008 asset experience is the leading cause of the negative cash flow at year end 2008. These components are shown in the following table along with figures for the previous three years for comparison purposes.

	2008	2007	2006	2005
Beginning Balance	62,022,782	60,722,872	62,548,480	64,107,888
Closing Adjustments	719,743	(47,211)	22,594	(18,654)
Adjusted Beginning Balance	**62,742,525**	**60,675,661**	**62,571,074**	**64,089,234**
Revenues				
Contributions	12,327,669	11,430,510	9,961,219	9,777,198
Investment Earnings	1,838,355	7,011,277	5,812,959	3,986,175
Total	**14,166,024**	**18,441,787**	**15,774,178**	**13,763,373**
Expenses				
Paid Claims	14,335,283	14,875,149	15,345,079	13,341,722
Administrative Expenses	2,214,424	2,219,517	2,277,300	1,962,404
Total	**16,549,706**	**17,094,666**	**17,622,379**	**15,304,126**
Net Income	**(2,383,682)**	**1,347,121**	**(1,848,201)**	**(1,540,754)**
Ending Balance	**60,358,843**	**62,022,782**	**60,722,872**	**62,548,480**
Investment Earnings/Mean Balance	**3.0%**	**12.1%**	**9.9%**	**6.5%**

As of December 31, 2008, there were 1,130 open claims. During 2008, 1,440 claims were closed. Total reported claims incurred during 2008 were 2,570. 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

	Open Claims		Closed Claims		All Claims	
Year Incurred	**Number**	**Average Net Benefit**	**Number**	**Average Net Benefit**	**Number**	**Average Net Benefit**
2008	338	$ 2,329	777	$ 2,352	1,115	$ 2,345
2007	133	1,242	554	2,106	687	1,939
2006	107	1,041	25	1,345	132	1,098
2005	93	1,065	21	1,165	114	1,084
2004	87	739	17	875	104	761
2003	52	651	10	1,033	62	713
2002	52	818	1	-	53	803
2001	34	748	1	549	35	742
2000	31	705	2	1,975	33	782
1999	28	743	1	230	29	725
1998	24	691	3	1,288	27	758
1997	21	558	-	-	21	558
1996	26	696	3	1,691	29	799
1995	19	674	3	596	22	663
1994	19	563	6	769	25	612
1993	10	677	1	427	11	654
1992	8	778	3	1,155	11	881
1991	12	1,230	-	-	12	1,230
1990 & Prior	36	783	12	693	48	760
Total	**1,130**	**$ 1,325**	**1,440**	**$ 2,160**	**2,570**	**$ 1,793**

The number of open and closed claims and their respective average benefit amounts in 2008 increased compared to last year. The following table shows this comparison for the last ten years.

Claims By Valuation Date

	Open Claims		Closed Claims		All Claims	
Plan Year	Number	Average Net Benefit	Number	Average Net Benefit	Number	Average Net Benefit
2008	1,130	$ 1,325	1,440	$ 2,160	2,570	$ 1,793
2007	1,064	1,128	1,412	997	2,476	1,065
2006	1,123	1,146	1,295	881	2,418	1,004
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

III. Estimated Liability as of December 31, 2008

The State's liability for outstanding claims under the State Income Continuation Insurance Plan 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 8.0% to 7.8% as of February 1, 2004, and has since remained at 7.8%. For consistency and per the direction of ETF personnel, the valuation interest rate is tied to the WRS valuation rate; therefore a 7.8% discount rate was used for the December 31, 2008, 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, 2008. The age at disablement, duration of disability, and duration to the end of the benefit period 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. A liability was added for those claims incurring in 2008 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.

Incurred But Unreported Claims

In addition to those claims reported as of December 31, 2008, there presumably are other claims incurred prior to that date but which are not 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 approximately 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, 2008, for the State Income Continuation Insurance Plan is $72,801,768, developed as follows:

Reported Claim Liability	$64,114,147
$75 Supplement	486,391
Total Reported Liability	64,600,538
Incurred But Not Reported Liability	8,201,229
Total Liability	$72,801,768

This total liability is 12% higher than the liability determined as of December 31, 2007, due to the combined effect of an increase in the count of open claims and an increase in the average net benefit.

Exhibit 2 contains a breakdown of the $64,600,538 reported liability by year of disability.

IV. Analysis of Funding Levels

The State Income Continuation Insurance Plan has assets of $60.4 million and estimated liabilities of $72.8 million, producing a net fund balance of $(12.4) million. The collected premiums covered 75% of paid claims and administrative expenses, while investment earnings covered only 11% of the remaining claims and administrative expense balance. Thus, cash flow in the trust was negative this year. Cumulative cash flows for plan years 2004 through 2008 are $(4,162,658).

Considerable year-to-year fluctuations can occur under disability income plans, even for a plan as large as that of 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 total fund balance covers 82.9% of liabilities (as compared to 96.8% last year). The net fund balance is not in the targeted range for the third consecutive year. As part of the December 31, 2005, valuation, Deloitte recommended a 7% increase in premium revenue, which took effect February 1, 2007. The increase in premium revenue led to a slight improvement in the funded status in 2007. However, an increase in the total estimated liability and the poor asset experience in 2008 led to further deterioration of the net fund balance. Additionally, there is currently $13.1 million of deferred investment losses which will be gradually smoothed into the fund by 2012. Hence we recommend a 7.0% increase to plan premium to be implemented in 2010. Further, based on current financial projections, it is anticipated that additional 7% premium increases will be recommended in future years to be implemented in 2012 and 2014 in order to return the net fund balance to target levels over the longer term.

Exhibit 1– Summary of Actuarial Assumptions

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, 2008								
Year of Disability	Count	Gross Benefit $	Offset Amount $	Net Benefit $	Estimated Liability $	$75 Supp	Ave. Ben $	Est'd Liability $
2008	338	870,545	83,506	787,038	17,559,055	486,391	2,329	18,045,446
2007	133	358,601	193,399	165,202	8,136,482	-	1,242	8,136,482
2006	107	277,236	165,874	111,361	7,416,693	-	1,041	7,416,693
2005	93	226,085	127,031	99,054	7,331,323	-	1,065	7,331,323
2004	87	198,996	134,728	64,268	4,740,531	-	739	4,740,531
2003	52	114,725	80,867	33,858	2,690,750	-	651	2,690,750
2002	52	119,644	77,100	42,544	2,832,144	-	818	2,832,144
2001	34	70,327	44,912	25,415	2,194,811	-	748	2,194,811
2000	31	61,683	39,813	21,870	1,585,302	-	705	1,585,302
1999	28	65,144	44,336	20,808	1,562,713	-	743	1,562,713
1998	24	55,520	38,928	16,592	1,015,132	-	691	1,015,132
1997	21	42,437	30,712	11,725	587,428	-	558	587,428
1996	26	48,317	30,222	18,095	1,308,974	-	696	1,308,974
1995	19	35,597	22,798	12,799	734,241	-	674	734,241
1994	19	32,939	22,251	10,688	731,152	-	563	731,152
1993	10	16,411	9,643	6,767	487,594	-	677	487,594
1992	8	13,563	7,343	6,221	464,833	-	778	464,833
1991	12	20,590	5,833	14,757	1,020,890	-	1,230	1,020,890
1990	7	9,621	4,364	5,257	345,908	-	751	345,908
1989	9	12,589	5,864	6,725	345,168	-	747	345,168
1988	7	12,004	4,152	7,852	528,549	-	1,122	528,549
1987	4	5,161	2,108	3,053	109,526	-	763	109,526
1986	2	2,199	1,415	784	48,474	-	392	48,474
1984	2	2,173	1,046	1,127	98,314	-	563	98,314
1983	2	2,303	431	1,872	141,422	-	936	141,422
1982	1	900	416	484	43,673	-	484	43,673
1980	1	802	308	494	34,068	-	494	34,068
1979	1	900	362	538	18,999	-	538	18,999
Total	**1,130**	**2,677,011**	**1,179,763**	**1,497,248**	**64,114,147**	**486,391**	**1,325**	**64,600,538**

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