Finance and Administration Committee

Agenda Item 6a

April 17, 2023

Item Name: Long-Term Care Valuation Report

Program: Actuarial

Item Type: Information

Executive Summary

This agenda item provides the results of the California Public Employees' Retirement System Long-Term Care (LTC) Program's annual actuarial valuation for the fiscal year ending June 30, 2022. As of June 30, 2022, the program's funded status is 95%, decreased from 108% last year, and the margin is negative 7.40%, decreased from positive 10.51% last year. As of June 30, 2022, the program had 105,370 policies in-force, 6,438 of which were on claim.

This valuation report reflects the 52% premium increases implemented in the 2021-22 fiscal year and the 25% premium increases in progress of implementation in the 2022-23 fiscal year.

In this valuation, the investment return experience had the most significant impact to the program's margin. The program experienced an investment return of negative 9.8% during the fiscal year, which reduced the program's margin by 20.34%.

This valuation report reflects the morbidity assumption updates incorporating more recent experience data and the removal of the morbidity improvement assumption. The morbidity assumption updates overall decreased the margin by 0.83%.

The in-force population data update from the prior valuation date to 6/30/2022 overall improved the margin by 2.89%. This update reflects the implemented 52% premium increase during the 2021-22 fiscal year. It also reflects the modestly higher-than-projected mortality and lower-than-projected new claims during the fiscal year partially due to COVID-19.

Other smaller assumption updates and actual experience in total increased the margin by 0.38%.

In fiscal year 2021-22, premiums received were $297.4 million, administrative expenses were $26.9 million, and claims payments were $318.9 million. The balance of the LTC Fund reduced by $581.3 million largely due to the investment return, resulting in a new fund balance of $4.9 billion as of June 30, 2022.

Strategic Plan

This agenda item supports the strategic plan goal of pension sustainability.

Background

The CalPERS LTC Program was established in 1995 and has 105,370 policyholders as of June 30, 2022. Information on the types of policies offered through the program and the number of policyholders under each type can be obtained from Appendix D of the valuation report.

Since its inception, the CalPERS LTC Program has experienced worse-than-expected morbidity, higher-than-expected claims, lower-than-expected voluntary termination, and lower-than-expected investment income. This experience is similar to that of other LTC insurance providers. Due to this experience, CalPERS has taken corrective action to stabilize the LTC Fund.

The 2019 valuation reported an underfunded status for the program due to higher projected liabilities and lower projected future investment returns. As a result, the board approved stabilization efforts that consisted of an asset allocation change and premium increases. A new discount rate of 4.75% was approved by the board in November 2020 and the associated asset allocation target was approved by the board in March 2021. The board also approved a two-year phased-in premium increase of 52% in 2021 and an additional increase of up to 25% in 2022. Options to convert to less expensive policies are offered to policyholders.

In 2017, the actuarial valuation adopted the First Principles Based modeling method. This modeling method is standard in the LTC insurance industry and provides better information to analyze assumptions. Assumptions for the First Principles Model have been developed and refined over the years to reflect emerging experience and new findings.

Analysis

Funded Status and Margin of the Program

The results of this actuarial valuation are based on the in-force data, revised assumptions, and the fund balance as of June 30, 2022. The funded status, as of June 30, 2022, is 95% and the margin is negative 7.40%.

The following table shows how the funded status and margin were derived and compares the key results from the June 30, 2021 valuation to the key results from the June 30, 2022 valuation:

Component	6/30/2021 ($ in Millions)	6/30/2022 ($ in Millions)
1. Present Value of Future Benefits	$8,473	$7,943
2. Present Value of Future Expenses	$385	$369
3. Present Value of Future Premiums (PVFP)	$3,819	$3,215
4. Valuation Liabilities (= 1 + 2 - 3)	$5,040	$5,098
5. Valuation Assets	$5,441	$4,860
6. Valuation Margin (= 5 - 4)	$401	($238)
7. Margin as a % of PVFP (= 6 / 3)	10.51%	(7.40%)
8. Funded Status (= 5 / 4)	108%	95%

Main Reasons for Changes in Margin

The investment return of negative 9.8% during the 2021-22 fiscal year, which was due to the rising interest rates and market volatility, was the main reason for the margin decrease in this valuation.

Morbidity assumption updates overall decreased the margin by 0.83%. The updates incorporated more recent experience data up to 6/30/2020, and generally excluded experience data after 6/30/2020 to prevent the distortion from COVID-19. The morbidity improvement assumption, which assumes a decreasing trend of future new claims, was removed in this valuation due to inconsistent industry-wide evidence and lack of direct data support.

The in-force population data update, which improved the margin by 2.89%, was the main factor that positively impacted the margin. This update reflects the premium rate increase during the fiscal year, as well as the modestly higher-than-projected mortality and lower-than-projected new claims.

The table below provides the breakdown for impacts on margin between 2021 and 2022.

	Change in Margin	Resulting Margin	Funded Status
Margin as of 6/30/21 valuation		10.51%	108%
FY21-22 Non-Investment Gain/Loss	0.34%	10.85%	108%
FY21-22 Investment Gain/Loss	(20.34%)	(9.50%)	93%
Update to 2022 Demographics	2.89%	(6.61%)	96%
Expense Assumption Update	(0.11%)	(6.72%)	96%
Lapse Assumption Update	0.00%	(6.72%)	96%
Mortality Assumption Updates	0.15%	(6.56%)	96%
Morbidity Assumption Updates	(0.83%)	(7.40%)	95%
Margin as of 6/30/22 valuation		(7.40%)	95%

History of Funded Status and Margin

The table below shows the funded status and the margin/(deficit) for the LTC Program for the last five years. The previous low-interest-rate environment and the corresponding long-term investment return expectation have had a large negative impact on the 2019 valuation margin. In addition, morbidity assumption and lapse assumption adjustments also contributed to the large decrease in the 2019 valuation margin. The stabilization plan to change the asset allocation and increase premium rates brought the margin back to positive in the 2020 valuation. The higher-than-expected investment return and the program experience due to COVID-19 increased the margin in the 2021 valuation. The rising interest rates and market volatility decreased the margin in the 2022 valuation.

Five Year History of Funded Status and Margin

Valuation Date	Funded Status	Margin
June 30, 2018	101%	1.20%
June 30, 2019	69%	(85.46%)
June 30, 2020	101%	1.34%
June 30, 2021	108%	10.51%
June 30, 2022	95%	(7.40%)

Budget and Fiscal Impacts

The June 30, 2022 actuarial valuation was prepared by CalPERS Actuarial team with the review from Risk Strategies Consulting actuaries. Funding was already identified within existing budgetary resources.

Benefits and Risks

The actuarial calculations performed as part of the actuarial valuation are based on several assumptions related to very long-term demographic and economic behavior. Unless the assumptions (morbidity, lapses, deaths, expenses, and investment return) are exactly realized each year, there will be differences between actual and projected cash flows on a year-to-year basis. The year-to-year differences between actual experience and the assumptions are called actuarial gains and losses and will either increase or decrease the funded status and margin of the LTC Program. If the actual experience differs from the assumptions over a prolonged period, it may indicate a need for assumption updates and result in a need for premium changes to ensure the financial integrity of the LTC Program.

Some LTC assumptions such as claim incidence rate, claim termination rate, and claim utilization rate can have more variability throughout a long period of time. These assumptions can be impacted over time by plan demographics, health care technologies, policyholder preferences, and shock events such as pandemics. Timely updating of valuation assumptions to reflect this information is beneficial for adequately monitoring the funded status of the program and minimizing the risk that actual experience is not in line with assumptions.

Demographic assumptions such as mortality rate can have a significant impact on the LTC Program if not realized over a long period of time. These assumptions in general are not subject to wide variances from year-to-year and typically the changes to these additional assumptions only gradually occur over time. Refer to the “Risk Analysis” section of the valuation report for more information on how sensitive the margin of the LTC Program is to the changes in key actuarial assumptions.

Investment return also poses a significant risk to the program if not realized over time. LTC insurance is characterized by level premiums and increasing claim costs over the coverage period. The collected premiums are invested and the aggregate premiums plus investment income are used to pay out future claims. Investment income is a significant component of the income as the block of insurance matures. If investment returns are lower than expected over a prolonged period, more premiums will be needed to make up for the reduced growth in assets.

Attachments

Attachment 1 – Long-Term Care Valuation Report as of June 30, 2022

Attachment 2 – Long-Term Care Valuation Presentation

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