

The State of Wisconsin



State Income Continuation Insurance Plan Actuarial Review as of December 31, 2004

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I. Overview

The purpose of this report is to summarize our review of the State Income Continuation Insurance Plan. Included is a brief review of the Plan's experience during 2004, an estimate of the State's liability as of December 31, 2004, 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 has assets of \$64.1 million and estimated liabilities of \$58.1 million as of December 31, 2004. The asset balance does not include \$10.5 million in deferred market gains which will be smoothed over the next five years. The net fund balance is \$6.0 million. This net fund balance represents approximately 10% 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. Since 2001 the funded status of the plan remained relatively stable. The annual net fund balances were 15% in 2001, 13% in 2002, 17% in 2003 and 10% in 2004. The funded status of the plan is not in the targeted range, however, an examination of the history of the results for the fund balance (page 2) and claims (page 5) reveals a history of fluctuations rather than a defined negative trend in the experience of this plan. Therefore we do not recommend a premium increase at this time.

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. 2004 Experience Review

Fund Balance

During 2004, the fund balance increased from \$64,035,892 to \$64,107,888; Investment earnings were \$5,090,324 with paid claims and administrative expenses totaling \$14,449,389. These components are shown in the following table along with figures for the previous three years for comparison purposes.

	2004	2003	2002	2001
Beginning Balance	64,035,892	62,699,536	62,727,574	58,443,292
Closing Adjustments	(190,862)	226,566	600,797	5,736,070
Adjusted Beginning Balance	63,845,030	62,926,102	63,328,371	64,179,362
Revenues				
Contributions	9,621,923	9,295,493	9,164,530	8,772,247
Investment Earnings	5,090,324	4,529,984	3,073,851	4,525,539
Total	14,712,247	13,825,478	12,238,381	13,297,786
Expenses				
Paid Claims	12,453,660	11,029,413	11,313,665	12,882,720
Administrative Expenses	1,995,729	1,686,275	1,553,552	1,866,855
Total	14,449,389	12,715,688	12,867,217	14,749,575
Net Income	262,858	1,109,790	(628,836)	(1,451,789)
Ending Balance	64,107,888	64,035,892	62,699,535	62,727,574
Investment Earnings/Mean Balance	8.3%	7.4%	5.0%	7.4%

As of December 31, 2004 there were 972 open claims. During 2004, 1,205 claims were closed. Total reported claims incurred during 2004 was 2,177. 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 Incurred

Year Incurred	Open Claims		Closed Claims		All Claims	
	Number	Average Benefit	Number	Average Benefit	Number	Average Benefit
2004	359	1,670	684	1,136	1,043	1,320
2003	122	1,273	351	1,029	473	1,092
2002	88	910	66	459	154	717
2001	64	786	50	672	114	736
2000	50	867	16	1,162	66	939
1999	35	844	6	917	41	855
1998	30	667	6	950	36	714
1997	31	554	2	1,948	33	639
1996	32	743	4	534	36	720
1995	31	688	3	440	34	666
1994	31	608	1	9,849	32	897
1993	15	573	5	367	20	521
1992	12	864	3	590	15	809
1991	13	1,110	4	237	17	905
1990	13	834	0	NA	13	834
1989	15	634	0	NA	15	634
1988 & Prior	46	693	4	478	50	676
Total	972	1,168	1,205	1,042	2,177	1,098

The number of open claims for 2004 increased compared to last year. However, the average benefit amount for these open claims decreased. The same conclusion can be said for the number of closed claims in 2004. 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
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, 2004

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, 2004 valuation. This caused an increase in liability of \$526,472. 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, 2004. 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 2004 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 31st, there presumably are other claims incurred prior to that date but which 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, 2004 for the State Income Continuation Insurance program is \$58,148,355, developed as follows:

Reported Claim Liability	\$49,032,901
\$75 Supplement	551,128
Total Reported Liability	\$49,584,029
Incurred But Not Reported Liability	8,564,326
Total Liability	\$58,148,355

This total liability is 6.5% higher than the liability determined as of December 31, 2003 due to an increase in the number of open claims, as well as a decrease in the valuation discount rate from 8% to 7.8%.

IV. Analysis of Funding Levels

The State Income Continuation Insurance program has assets of \$64.1 million and estimated liabilities of \$58.1 million, producing a net fund balance of \$6.0 million. Investment earnings covered 35% of paid claims and administrative expenses. The reinstated premiums cover 67%. Premiums plus earnings combined covered 102% of the paid claims and administrative expenses. Thus, cash flow in the trust was positive this year.

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 10% of liabilities as compared to 17% last year. This is no longer within the targeted range. However, we do not recommend change to the premium rates at this time. Should the funded status deteriorate further or remain chronically below the targeted range, premiums may need to be increased at a future date. We will continue to monitor the experience closely to evaluate the need for additional changes.

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, 2004						
Year of Disability	Number	Gross Benefit	Offset Amount	Net Benefit	Average Benefit	Estimated Liability
2004	359	742,100	142,692	599,408	1,670	14,919,627
2003	122	260,273	104,967	155,306	1,273	7,617,040
2002	88	190,100	110,027	80,073	910	5,078,210
2001	64	130,227	79,931	50,296	786	3,643,990
2000	50	99,369	56,022	43,347	867	3,394,478
1999	35	75,374	45,827	29,547	844	2,398,594
1998	30	65,282	45,269	20,013	667	1,399,798
1997	31	64,059	46,884	17,175	554	1,123,972
1996	32	57,361	33,585	23,776	743	1,794,703
1995	31	59,979	38,662	21,316	688	1,423,609
1994	31	53,055	34,199	18,856	608	1,302,500
1993	15	23,889	15,295	8,594	573	626,296
1992	12	18,766	8,398	10,368	864	856,783
1991	13	21,104	6,673	14,431	1,110	1,226,563
1990	13	20,500	9,652	10,848	834	638,412
1989	15	20,985	11,478	9,507	634	641,350
1988	8	13,819	5,106	8,713	1,089	645,397
1987	6	7,581	3,859	3,723	620	224,745
1986	2	2,049	1,373	676	338	55,926
1985	1	2,675	889	1,786	1,786	85,704
1984	5	4,774	2,559	2,215	443	157,006
1983	2	2,153	431	1,722	861	151,970
1982	2	1,821	705	1,116	558	65,319
1980	1	727	308	419	419	36,266
1979	3	2,524	997	1,527	509	61,992
1972	1	474	0	474	474	13,779
Total	972	1,941,018	805,787	1,135,231	1,168	49,584,029



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