

The State of Wisconsin



State Income Continuation Insurance Plan Actuarial Review as of December 31, 2006

Table of Contents

I. Overview	1
II. 2006 Experience Review	2
III. Estimated Liability as of December 31, 2006	5
IV. Analysis of Funding Levels	7
Exhibit 1: Summary of Actuarial Assumptions	7
Exhibit 2: Reported Claim Liability by Year of Disability	9

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 2006, an estimate of the State's liability as of December 31, 2006, 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. 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 (including supplemental) has assets of \$60.7 million and estimated liabilities of \$67 million as of December 31, 2006. The asset balance does not include \$15.2 million in deferred market gains which will be smoothed in over the next four years. The net fund balance is \$(6.3) million. This net fund balance represents approximately (9.4)% 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 were 15% in 2001, 13% in 2002, 17% in 2003, 10% in 2004 and (1.5)% in 2005. Recently, the funded status of the plan has deteriorated and is no longer in the targeted range. The funded status of the plan is (9.4)% at the end of 2006. In order to rectify this, we recommended an increase in premium revenue of approximately 7% last year. This recommended premium increase took effect February 1, 2007. Hence this impact had not been felt as of December 31, 2006.

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. 2006 Experience Review

Fund Balance

During 2006, the fund balance decreased from \$62,548,480 to \$60,722,872; Investment earnings were \$5,812,959 with paid claims and administrative expenses totaling \$17,622,379. These components are shown in the following table along with figures for the previous three years for comparison purposes.

	2006	2005	2004	2003
Beginning Balance	62,548,480	64,107,888	64,035,892	62,699,536
Closing Adjustments	22,594	(18,654)	(190,862)	226,566
Adjusted Beginning Balance	62,571,074	64,089,234	63,845,030	62,926,102
Revenues				
Contributions	9,961,219	9,777,198	9,621,923	9,295,493
Investment Earnings	5,812,959	3,986,175	5,090,324	4,529,984
Total	15,774,178	13,763,373	14,712,247	13,825,478
Expenses				
Paid Claims	15,345,079	13,341,722	12,453,660	11,029,413
Administrative Expenses	2,277,300	1,962,404	1,995,729	1,686,275
Total	17,622,379	15,304,126	14,449,389	12,715,688
Net Income	(1,848,201)	(1,540,754)	262,858	1,109,790
Ending Balance	60,722,872	62,548,480	64,107,888	64,035,892
Investment Earnings/Mean Balance	9.9%	6.5%	8.3%	7.4%

As of December 31, 2006 there were 1,123 open claims. During 2006, 1,295 claims were closed. Total reported claims incurred during 2006 were 2,418. 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 Incurral

Year Incurred	Open Claims		Closed Claims		All Claims	
	Number	Average Benefit	Number	Average Benefit	Number	Average Benefit
2006	366	1,630	679	891	1,045	1,150
2005	155	1,384	536	909	691	1,016
2004	134	1,007	24	774	158	972
2003	74	860	17	660	91	823
2002	62	781	6	388	68	746
2001	44	715	6	516	50	691
2000	36	664	7	556	43	646
1999	30	781	3	118	33	721
1998	27	678	1	621	28	676
1997	25	573	1	201	26	559
1996	29	750	1	1,843	30	787
1995	25	618	5	390	30	580
1994	25	567	3	567	28	567
1993	14	538	0	N/A	14	538
1992	11	693	1	331	12	663
1991	12	1,192	1	232	13	1,118
1990	13	614	0	N/A	13	614
1989	13	629	2	352	15	592
1988 & Prior	28	704	2	1,073	30	728
Total	1,123	1,146	1,295	881	2,418	1,004

The number of open claims for 2006 increased compared to last year, while the average benefit amount decreased for these open claims. Closed claims also saw an increase in 2006 while the average benefit decreased as well. 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
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
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, 2006

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, 2006 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, 2006. 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 2006 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, 2006 for the State Income Continuation Insurance program is \$67,026,862, developed as follows:

Reported Claim Liability	\$58,146,457
\$75 Supplement	509,532
Total Reported Liability	\$58,655,989
Incurred But Not Reported Liability	8,370,873
Total Liability	\$67,026,862

This total liability is 5.7% higher than the liability determined as of December 31, 2005 due in large part to an increase in the number of open claims.

IV. Analysis of Funding Levels

The State Income Continuation Insurance program has assets of \$60.7 million and estimated liabilities of \$67 million, producing a net fund balance of \$(6.3) million. Investment earnings covered 33% of paid claims and administrative expenses. The premiums cover 57%. Premiums plus earnings combined covered 90% of the paid claims and administrative expenses. Thus, cash flow in the trust was negative this year. We reviewed cumulative cash flows for plan years 2002 through 2006. It is (\$2,645,143).

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 total fund balance is 90.6% of liabilities as compared to 98.5% last year. This is not in the targeted range for the second consecutive year. Also, the cash flow to the fund has been negative the past two years. Last year, we recommended an increase in premium revenue of approximately 7%. The recommended premium increase went into effect February 1, 2007. Hence its impact was not felt in the December 31, 2006 valuation.

Also, there is currently in excess of \$15 million of deferred investment gains which will be smoothed into the fund over the next four years. Hence we recommend that the plan's experience be monitored for 1 to 2 years before another premium increase is considered.

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, 2006						
Year of Disability	Number	Gross Benefit	Offset Amount	Net Benefit	Average Benefit	Estimated Liability
2006	366	674,077	77,423	596,654	1,630	14,789,578
2005	155	325,968	111,413	214,555	1,384	11,374,390
2004	134	302,008	167,032	134,976	1,007	8,712,567
2003	74	159,231	95,556	63,674	860	4,569,013
2002	62	139,407	90,982	48,425	781	3,319,486
2001	44	90,832	59,353	31,479	715	2,436,513
2000	36	72,473	48,570	23,902	664	1,844,427
1999	30	66,840	43,398	23,441	781	1,888,665
1998	27	57,892	39,580	18,312	678	1,195,958
1997	25	52,312	37,977	14,334	573	801,317
1996	29	53,429	31,670	21,759	750	1,527,365
1995	25	46,903	31,451	15,452	618	941,104
1994	25	40,815	26,633	14,182	567	940,564
1993	14	21,996	14,464	7,532	538	506,683
1992	11	16,988	9,363	7,625	693	557,866
1991	12	21,237	6,929	14,308	1,192	1,121,627
1990	13	20,500	12,522	7,978	614	448,187
1989	13	18,508	10,326	8,182	629	460,311
1988	7	11,479	4,152	7,327	1,047	561,501
1987	5	6,380	3,140	3,240	648	152,584
1986	2	2,049	1,415	634	317	48,223
1985	1	2,675	889	1,786	1,786	56,924
1984	5	4,774	2,559	2,215	443	134,065
1983	2	2,153	431	1,722	861	141,811
1982	2	1,821	705	1,116	558	50,051
1980	1	727	308	419	419	32,923
1979	2	1,764	997	767	384	38,071
1972	1	474	0	474	474	4,215
Total	1,123	2,215,708	929,239	1,286,469	1,146	58,655,989



Deloitte Consulting LLP
400 One Financial Plaza
120 South Sixth Street
Minneapolis, MN 55402-1844
United States

Tel: 612 397 4000
Fax: 612 397 4450
www.deloitte.com

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