AMERICAN ACADEMY *of* ACTUARIES

October 3, 2013

Steve Ostlund
Chair, Health Actuarial Task Force
National Association of Insurance Commissioners
2301 McGee Street, Suite 800
Kansas City, MO 64108-2662

Re: Final Proposed Actuarial Guideline for Group Long-Term Disability Insurance

Dear Steve,

Attached is the final proposed actuarial guideline from the American Academy of Actuaries'[1] Group Long-Term Disability Work Group for exposure by the Health Actuarial Task Force. The purpose of the guideline is to provide instruction for the use of the 2012 Group Long-Term Disability Valuation Table that is referenced in the Health Insurance Reserves Model Regulation.

In addition, for information purposes, attached is the work group's final report.

Should you have any questions, please contact Tim Mahony, the Academy's state health policy analyst (Mahony@actaury.org or 202-223-8196).

Sincerely,

Roger Martin, MAAA, FSA
Co-chairperson, Group Long-Term Disability Work Group
American Academy of Actuaries

[1] The American Academy of Actuaries is a 17,500-member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualifications, practice, and professionalism standards for actuaries in the United States

A. Background

In August 2009, the Society of Actuaries Group Disability Experience Committee (SOA GDEC) published a study regarding the Jan. 1, 1997 to Dec.31, 2006 GLTD Termination Experience of over 20 long-term disability (LTD) carriers, representing about 72 percent of the long-term disability (LTD) industry. The study included over 1.2 million claims and over 680,000 terminations segmented by many key variables known by the industry as significant drivers of experience. The SOA GDEC proceeded to use the study results to build a new table: the GLTD 2008 Experience Table, published in June 2011.

The last step for the SOA GDEC was to present the new table to the Health Actuarial Task Force (HATF) of the NAIC, with the objective of starting a project that would incorporate the new table into the GLTD valuation standards. In March 2012, HATF asked the American Academy of Actuaries (Academy) to form a work group, the joint Academy/Society of Actuaries Group Long-Term Disability Work Group (GLTDWG), which was charged with revising the valuation standard to replace the Commissioner's Group Disability Table 1987 (CGDT87 Table) with a new one based on the GLTD 2008 Table. This table is referred to as the GLTD 2012 Valuation Table and can be found at the following location:
http://www.naic.org/documents/committees_b_ha_tf_exposures_gltd_2012_valuation_table_exposure.xls

The work group believes that the use of an actuarial guideline is more appropriate to handle the multiple segments of the 2012 GLTD Valuation Table, the computations of own experience and the application of credibility which are not normally found in model regulations.

The purpose of this proposal is to provide recommendations to the National Association of Insurance Commissioners (NAIC) regarding a new NAIC actuarial guideline and to provide an instruction for the use of the 2012 Group Long-Term Disability (GLTD)

Valuation Table that is referenced in the Health Insurance Reserves Model Regulation. Changes were provided by the Academy to the NAIC in August 2012 for consideration as changes to the Health Insurance Reserves Model Regulation. This guideline pertains to Group Long-Term Disability claims consistent with the conditions defined in the model regulation, and governs the selection of claim termination rates for the purpose of calculating GLTD claim reserves. This guideline does not address reserve adequacy, which remains the concern of the group insurer according to the terms expressed in the model regulation.

Although the various detailed formulas in this guideline do not directly address or define reserve adequacy, it is assumed that appropriate adequacy tests will be made periodically. Such adequacy testing is considered to be an additional tool for the actuary to make appropriate choices where leeway from any prescription made herein is allowed (A/E calculation, margin, etc.) so that the calculation of the reserve will generally be adequate and the actuary does not need to continually rely on other measures to achieve adequacy. In addition to the few times that leeway from prescription is mentioned below, nothing in this guideline should be assumed to prohibit the actuary from building a case and requesting permission from the state insurance commissioner for other appropriate variations. Many such situations, because they would apply to fully credible blocks of business and are intended for continual use, should be considered for approval by the commissioner for a period tied to the updates required by section C.vi. and not approved on an annual basis.

When the insurer follows the instructions modeled in this guideline, the selected claim termination rates automatically should meet the minimum valuation standard defined in the model regulation.

B. Valuation Table Modifications

If not invoking the small company exception specified in Section D, a company must use a credibility-weighted combination of its own claim termination experience with the 2012 GLTD Valuation Table to create its specific valuation table.

i. For claims in Duration Group 1 (duration <= 3 months), termination rates may be developed as below consistent with other Duration Groups or in any other manner deemed appropriate by the actuary. With respect to credibility, any value between 0 and 1.0 that the actuary deems appropriate for the block may be used.

~~i.~~ii. For claims beyond 3 months, the valuation termination rates shall be computed using the termination rates from the 2012 GLTD Valuation Table (S) multiplied by experience adjustment factors (T) that are calculated separately for four different duration groups.

$$\text{Valuation Termination Rate} = T \text{ x } S$$

The duration groups are defined as follows:

Group 2: duration > 3 months and duration <= 24 months

Group 3 duration > 24 months and duration <= 60 months

Group 4: duration > 60 months and duration <= 120 months

Group 5: duration > 120 months

a) S shall be the sum of recovery and death rates from the 2012 GLTD Valuation Table; and

b) T shall be computed as $T = [Z \text{ x } F * (1\text{-}M) + (1 - Z)]$.

1) Z shall be a credibility weighting factor, between 0 and 1, developed for each duration group according to the following specifications:

2) Group 2-5: $Z = Min\left(\sqrt{N/K}, 1\right)$ N is the number of expected recovery and death counts from the 2012 GLTD Valuation Table.

3) K is a set of constants defined by duration group as follows:

Group 2: K = 3,300	Group 4: K = 2,100
Group 3: K = 2,500	Group 5: K = 1,700

4) F shall be the ratio of the company's actual total of recovery and death counts to the expected recovery and death counts for the 2012 GLTD Valuation Table for each duration group specified above;

If the actuary has reserve adequacy or other significant analysis that demonstrates in the development and use of Company Specific Experience (see Section C below) that some other weighting of claims (gross benefit, net benefit, etc.) is not only appropriate for measuring A/E, but also is expected to generally produce reserves not less than those produced by using a claim count measurement, such alternative measurement is deemed appropriate.

5) M is the company experience margin, determined for each duration group according to the following formula:

$$M = Min\left(15\%, Max\left(5\%, 3\% + 1.65 * \sqrt{A/_C}\right)\right)$$

This is the minimum value for the definition of M prior to any reserve adequacy analysis. Adequacy tests and analysis of experience (sharpness of fluctuations, trends over the period of the termination rate study, changing claims practices, etc) may indicate that a larger value of M may be more appropriate. If so, such a value is deemed appropriate.

6) A is a set of constants defined by duration group as follows:

Group 2: A = 4.0	Group 4: A = 2.5
Group 3: A = 3.0	Group 5: A = 2.0

7) C shall be the company's actual number of total recovery and death counts by duration group

iii. -The company shall not use termination rates that produce total reserves for claims disabled for more than two years that are less than the reserves produced for these claims by computing T as T = 1.30. If the Company Specific Experience, determined in Section C below, for Duration Group 3 includes at least 5,000 claim terminations, the value of T for that Duration Group shall not be limited to <= 1.30

C. Company Specific Experience–Own Experience Measurement

In computing values F and S to comply with section B above, the appointed actuary shall:

i. Segment the company claim termination experience into any major subgroups that may produce significantly different results (e.g., market niches, claims operations, unique benefit designs, etc.);

ii. Combine affiliated statutory entities and assumed reinsurance, where claim management is under a common structure, when considering company experience. It is also appropriate to evaluate experience separately when specific blocks of company business have distinct claim management practices or significantly different risk characteristics.

iii. Include all relevant experience the company is capable of providing for as many of the last five years as possible (not including the lag period described below). However, there are two situations where using other than a five-year period may be more appropriate. The first is when a company's experience in a longer period not only increases credibility but is still relevant and appropriate for the company's products and claim management practices. The second may be for a company that has had significant changes in product and/or claim management practices within the past five years that has diminished the relevance of the company's experience early in the five year period. In this second situation, less than five years of experience may be used for any duration band for which there is both compelling logic and either the company's experience to be used is at least 90 percent credible, or the shorter experience period produces higher reserves than using five years

~~iii.~~iv. Recognize a suitable lag period to allow for a full resolution of claim status. The ~~recommended~~ lag period ~~based on~~ used in the 2008 GLTD Study was ~~is~~ 12 months. However, the appointed actuary may use a different lag period based on his or her company experience. For example, company experience indicates that all changes after the selected lag period are negligible~~, or the five-year period mentioned above does not include the lag period.~~.

~~iv.~~v. Measure actual (A) to expected (E) terminations based on claim count (unless another weighting is deemed more appropriate, as mentioned in Section B (ii) (b) 4), -where the E is based on monthly expected recoveries and deaths from the 2012 GLTD Valuation Table. Claim count is also used in the measurement of credibility.

~~v.~~vi. Update the minimum valuation basis in accordance with section B above at least once every five years. In addition, the valuation basis also must be updated whenever the company's annual own experience study produces, in accordance with section B, a value T that changes by more than 10 percent from~~or more than~~ the one used in the current valuation basis for any of the five duration groups.

~~vi.~~vii. ~~Take advantage (when appropriate)~~ Recognize where appropriate ~~of~~ any flexibility built into the 2012 GLTD Valuation Table, such as not utilizing diagnosis-specific termination rates when the information is deemed unreliable.

~~vii.~~viii. Do not count as terminations those claims that are closed due to settlement (i.e., a lump sum replacing a series of potential future payments), or that have reached the end of the maximum benefit duration, or that are closed due to a contractual limit, such as a mental and nervous limit. For this purpose a termination due to a change in definition of disability is not considered a termination due to reaching the maximum benefit duration.

~~viii.~~ix. Use experience that is otherwise relevant in accordance with the professional judgment of the appointed actuary.

~~ix.~~x. Do not use experience that the commissioner has deemed inappropriate or likely to produce significantly inadequate reserves.

In the above paragraphs, the expression term “company” refers to a single company or a group of legally related companies subject to the same claim management

D. Own Experience Measurement Exemption

If, at the time of valuation, a company has fewer than 50 open claims disabled within two years of the effective date of the valuation, and fewer than 200 open claims disabled more than two years prior to the effective date of the valuation, the carrier is exempt from the requirement that the 2012 GLTD Valuation Table be modified by the company’s own experience. Said company will use 100 percent of the 2012 Valuation Table for calculating claims termination rates in order to comply with the minimum valuation standard.