

Long-term Care Combination Product Valuation Practice Note

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Survey

- The Work Group, in conjunction with the Academy Research Task Force, conducted a survey of carriers completing Form 4 of either the 2015 or 2016 LTC Experience Exhibit.
- The survey addresses Generally Accepted Accounting Principles (GAAP), statutory and tax valuation assumptions and methods.
- The survey and responses are included in the appendix to the draft practice note in their entirety.



Survey

- Relevant Pool of Companies:
 - ▣ 24 life insurance companies filed Form 4 with their LTC Experience Reports, indicating they had LTC Combo riders in their inforce book of business either on December 31, 2015, or December 31, 2016.
 - ▣ See Appendix 1 of the survey for the list of the 24 companies.
- Sample:
 - ▣ We contacted Academy members at 22 of the 24 companies, requesting their participation in the survey.



Survey

- Survey Time Period: 7/6/2017 – 8/11/2017.
- Response:
 - We received completed surveys from eight of the 22 companies (36%). Of those eight, two indicated they did not have LTC Combo riders in their inforce book of business as of December 31, 2016.
 - The six companies with relevant riders reported on 11 such products.
 - Of the 11, one reported a deferred annuity as a base plan.



Limitations

- As only one company reported on a deferred annuity as a base plan, annuity valuation is not included in the practice note (PN).
- Following the passage of the Tax Cuts and Jobs Act (TCJA), we resurveyed for the tax valuation questions. We received no responses, therefore the question and answer on tax reserves does not address a range of practices, only the requirements of TCJA.
- Financial Accounting Standards Board (FASB) Long Duration Targeted Improvements is not addressed.



Topics Addressed

- Statutory Reserves
- Provisions for Adverse Deviations (PADs)
- Mortality
- Lapses
- Tax Reserves
- GAAP Reserves
- Disabled Life Reserves
- Yearly Renewable Term (YRT) Long-Term Care (LTC) Rider



Statutory Reserves

Question 1: Are statutory LTC rider reserves usually developed independent of life reserves, or as an integrated calculation?

- ❑ PN addresses citations from LTC Model Regulation, the Universal Life Insurance Model Regulation, and VM20. Requirements are not consistent regarding separate reserve models, and separate premiums vs. charges for LTC benefits.
- ❑ From the survey results, companies report using a separate reserve calculation individually for both accelerated benefits (AB) and extension of benefit riders using a 1-Year Preliminary Term basis.
- ❑ One survey response reported using one-half the discounted cost of insurance for the current age ($\frac{1}{2}$ cx) for the LTC AB rider reserve.



Provisions for Adverse Deviation (PADs)

Question 2: When are PADs required in statutory reserve calculations for combination products, and how are they derived when PAD might increase reserves for the LTC rider and decrease the present value of the liabilities for the base plan?

- May have offsetting impacts between life and LTC benefits.
- LTC Model Regulation 641, Section 18A, a reserve developed for life coupled with LTC AB riders should never be less than the standalone life reserve.
- Current range of practice on PADs includes testing of PADs on multiple assumptions, with a review of results for reasonableness and with the principle of increasing total reserves over unpadding levels.



Mortality

Question 3: What mortality basis is used in the development of statutory LTC rider reserves?

- Standard Valuation Law (SVL) – No notable guidance is provided on combo products.
- Valuation of Life Insurance Model Regulation – Riders are not specifically mentioned in this regulation.
- Health Insurance Reserve Model Reg Section 4.B – 1994 GAM (group annuity mortality table) is prescribed for valuation mortality for LTC.
- A multi-decrement model would use one valuation mortality table.
- Adverse mortality experience reduces the life insurance profits but increases the LTC rider profits, as fewer people will survive to claim LTC benefits. One of the key synergies of combo products.



Lapses

Question 4: What issues arise when utilizing lapse assumptions in the development of statutory LTC rider reserves?

- LTC Model Regulation 641 section 18A, accelerated LTC benefits on life contracts.
 - Multiple decrement model utilizing all relevant decrements except voluntary terminations.
 - Single decrement approximations are acceptable if the calculation produces essentially similar reserves, if the reserve is clearly more conservative, or if the reserve is immaterial.
- Health Insurance Reserve Model Regulation requirements for voluntary terminations.
- Most companies in the LTC combo product market are using separate calculations for reserves on the life base plan and active life (“contract”) reserves on LTC AB riders.



Tax Reserves

Question 5: What are the considerations in the development of tax basis reserves for LTC riders on life or annuities?

- ❑ TCJA was effective 1/1/2018.
- ❑ Tax reserve for life insurance reserves is 92.81% of the reserve using the prescribed method. The cap of the statutory reserve and floor of the net surrender value is unchanged for TCJA.
- ❑ Section 811(a) of the Internal Revenue Code (IRC) prescribes the assumptions used “for purposes of the annual statement approved by the National Association of Insurance Commissioners.”
- ❑ No longer prescribed tables and interest other than those used for the statutory reserves. The method for LTC is 2-Year Preliminary Term for issue years prior to 1992, or 1-Year Preliminary Term for issue years 1992 and subsequent.



GAAP Reserves

Question 6: What are the considerations in the GAAP valuation of LTC riders on life policies?

- Five responses that separate reserves were calculated for the LTC rider including both AB and extension of benefit riders. Valuation models for the life insurance and LTC benefits are separate, each with their own methods and assumptions.
- Three responses that an integrated calculation with a multi-decrement approach was used. Most common integrated calculation uses FASB Statement of Position (SOP) 03-1.
 - Are insurance liabilities required in addition to the account balance?
 - SOP 03-1 requires a “profits followed by losses” test, “if the amounts assessed against the contract holder each period for the insurance benefit feature are assessed in a manner that is expected to result in profits in earlier years and losses in subsequent years from the insurance benefit function.”



Disabled Life Reserves

Question 7: What are the considerations in the development of statutory disabled life reserves for LTC riders on life or annuities?

- ❑ Disabled Life Reserve (DLR) generally calculated using claim termination rate assumptions, benefit utilization, and valuation interest discount rates.
- ❑ Some companies reflect recoveries in termination rates, others use on-claim mortality only.
- ❑ AB claim benefit is two components, surrender value of the base plan, and Net Amount at Risk (NAR). Surrender value is a floor to reserves, so many would establish DLR based on NAR only with remainder a reduction to surrender value.
- ❑ Situs of care may not be reflected (aggregate termination rates), or original situs, or current situs.



YRT LTC Rider

Question 8: What are the considerations in the development of the active life reserve methodology for an LTC AB rider with Yearly Renewable Term (YRT) premiums or charges?

- From the survey results, most companies use separate models for the base policy and the LTC rider.
- Consider the slope and structure of the YRT LTC premium scale.
 - If the slope is materially the same as the LTC claim costs, $\frac{1}{2}$ cx may be appropriate.
 - For premium structure that becomes level or ceases at an attained age, pre-funding the claims at those attained ages through the active life reserve may be considered.
- For a valuation using an integrated model for the base and LTC rider, the reserve will be based on the combined cash flows.



Status

- Currently exposed for 45-day comment period, ending September 2, 2019.



Questions?



For More Information

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