# 8/11/2016 - 2/27/17 draft improvements

# Actuarial Guideline LTC

**THE APPLICATION OF ASSET ADEQUACY TESTING TO LONG-TERM CARE INSURANCE RESERVES**

**Background**

The *Health Insurance Reserves Model Regulation (#010)* and the *NAIC Valuation Manual (VM-25)* contain requirements for the calculation of long-term care insurance (LTC) reserves. Regulators have observed a lack of uniform practice in the implementation of tests of reserve adequacy and reasonableness of LTC reserves. For instance, the *Model Regulation* states, “a gross premium valuation is to be performed whenever a significant doubt exists as to reserve adequacy with respect to any major block of contracts”; however, other wording in the *Model Regulation* creates confusion for some on whether the test of adequacy is required at the major block of contract level. In the absence of uniform guidance, insurers may not be determining adequacy of LTC reserves in a uniform manner. As such, this Guideline provides uniform guidance and limits to certain assumptions for the asset adequacy testing applied to an insurer’s major LTC block of contracts. In particular, this Guideline:

1. Requires asset adequacy analysis of an insurer’s LTC business that falls within the scope of the Guideline (LTC business).
2. Specifies that the appropriate form of asset adequacy analysis may be in the form of a gross premium valuation or in a more robust form, such as cash-flow testing, with Actuarial Standards of Practice providing guidance in this area.
3. Provides a process and maximum timeframe for increasing reserves determined to be inadequate, where applicable.
4. Requires a uniform approach to assumptions regarding future rate increases.
5. Provides requirements on documentation of assumptions associated with all key LTC risks.
6. Provides requirements for documentation of standalone LTC asset adequacy testing results.

# Text

# Effective DateThis Guideline shall be effective for reserves reported with the December 31, 2017 and subsequent annual statutory financial statements.

# ScopeThis Guideline shall apply to an insurer with long-term care insurance contracts with over 10,000 inforce lives as of the valuation date. All long-term care insurance contracts, whether directly written or assumed through reinsurance are included. Accelerated death benefit products or other combination products where the substantial risk of the product is associated with life insurance or an annuity are not subject to this Guideline.

# 3. Asset Adequacy Analysis of LTC Business

# A. As stated in Actuarial Standard of Practice (ASOP) No. 22, multiple asset adequacy analysis methods, including cash-flow testing and gross premium valuation, are available to actuaries.

# The method of analysis used for LTC shall conform with ASOP No. 22 in recognition of the typical significant asset- and liability-related risks associated with LTC.

# B. Reserves for LTC business must be supported by an asset adequacy analysis specific to LTC business for valuations associated with the December 31, 2017 and subsequent annual statutory financial statements. The analysis shall comply with applicable Actuarial Standards of Practice, including standards regarding identification of key risks (assumptions) associated with the LTC business shall be determined testing moderately adverse deviations in actuarial assumptions.

# C. When determining whether additional reserves are necessary:

# In the case where cash-flow testing is used both for LTC business and for the companywide analysis,

# A deficiency in the LTC segment may be offset by a projected and justified overall cash-flow testing sufficiency in non-LTC segments. The LTC-related assumptions in the companywide cash-flow testing shall be the same as with the standalone LTC cash-flow testing.

# To the extent projected LTC reserve insufficiency is not offset through aggregation, reserves for LTC business shall be increased by any additional reserves required to eliminate the projected reserve insufficiency.

# Requirements for standalone analysis for a health insurance major block of contracts, per *Model Regulation #010*, still apply even if aggregation of cash-flow testing results occurs.

# 2. In cases where cash-flow testing is not used for LTC business, reserves for LTC business shall be increased by any additional reserves required by the standalone LTC business asset adequacy analysis to eliminate a reserve insufficiency.

# 3. Phase-in of additional reserves according to considerations stated in Section 3.F. may be available.

#  D. When determining the effect of investment returns or the time value of money:

# 1. In the case where cash-flow testing is used, the analysis shall represent investment income associated with LTC business consistently with the way assets within the General Account are managed. If a segment of the General Account is used to manage the investment risk for LTC business, the assets from that segment should be appropriately represented within the asset adequacy analysis whether asset cash flows are explicitly generated or whether a simpler method to reflect investment income is used in the analysis.

# 2. In the case where a gross premium valuation method is used or asset cash flows are not explicitly modeled, the discount rate used by the actuary must reflect consideration of the yield on current assets held to support the liability as well as future yields on assets purchased with future premium income and reinvestments or anticipated divesture of existing assets.

# E. The analysis shall anticipate no premium rate increases unless a rate increase plan is documented, is supported by and has been approved by management, is highly likely to be executed, and contains documented, realistic estimated approved amounts and implementation timelines by jurisdiction.

# F. If the standalone asset adequacy analysis for LTC business demonstrates a potential need for additional reserves, with or without offsets from non-LTC business as contemplated in section 3.C., a phase-in period of up to three years may be approved by the company’s domiciliary Commissioner. Such phase-in period shall only be permitted if the company is able to demonstrate to the satisfaction of the Commissioner that it would not be operating in a hazardous financial condition and that there is not adverse risk to its insureds.

# G. The asset adequacy analysis shall be in the form of an Actuarial Memorandum which contains documentation of the assumptions and results of the analysis and shall be submitted to the state of domicile of the company by the April 30 following the valuation date. The company shall provide a copy of the Actuarial Memorandum to any state in which the company is licensed, upon request.

# 4. Documentation of Assumptions Underlying Long-Term Care Insurance Asset Adequacy Analysis to be provided in the Standalone Actuarial Memorandum

# A. Assumptions on mortality shall be documented to state the reference standard valuation table, if applicable, and explicitly site adjustments, select factors, and mortality improvement factors, where applicable. If a reference standard valuation table is not used in setting the mortality assumption, then a table of rates and comparison of the applied rates to rates from an unmodified standard mortality table for sample issue ages shall be provided. A summary of experience or other actuarial support of assumptions used shall be documented.

# B. Assumptions on voluntary lapse shall be documented in table format by duration band and by other factors such as gender, marital status, with versus without inflation rider, and length of benefit period impacting the lapse assumption, where applicable. A summary of experience or other justification of expectations shall be documented.

# C. Assumptions on morbidity shall be documented and justification of the assumption shall be provided. If an outside source is used as the basis for morbidity assumptions, then the rationale for the applicability of that source and any adjustments to the factors from that source shall be documented.

# D. Assumptions on investment returns and interest rates shall be documented. If a simplified approach is applied, such as implicit reflection of projected investment returns through the use of discount rates in a gross premium valuation as contemplated in Section 3.D., then justification shall be provided.

# E. Assumptions on future rate increases shall be documented, by rate increase percentage assumed and jurisdiction; and the documentation and justification stated in Section 3.E. shall be provided.

# F. Documentation of other material assumptions shall be provided.

# G. Documentation shall be provided for assumptions that have significantly changed from the prior year’s analysis.