

State Long-Term Care Principles-Based Work Group Presentation to the A&HWG

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Why Are We Here?

- Principles-based valuation continues to progress
- Health is an important aspect
- A long-term care policy's expected lifetime make it a suitable product for PBR



What Are We Talking About?

- Long-Term Care – Risk Characteristics
- Long-Term Care and Principles-based Valuations
- Update from the Technical and Issue Subgroups
- Questions for the Regulators



Long-Term Care: Risk Characteristics

Of Particular Significance:

- Lapse Rates
- Morbidity
- Interest Rates



Current Valuation and Accounting Bases

Current Valuation Bases

- ❖ Standard Valuation Law
- ❖ Health Insurance Reserve Model Regulation
- ❖ Health Reserve Guidance Manual

Current Statutory Accounting Bases

- ❖ AP&P Manual, SSAP #54 & SSAP #55
- ❖ AP&P Manual, primarily Appendix A-010
- ❖ AP&P Manual, primarily Appendix A-641

LTC Statutory Reserves Must Meet:
Minimum Statutory Reserve Standards
Gross Premium Valuation Testing
Asset Adequacy Test



Current Valuation of LTC Policies

Before Claim (Active Life Reserves)

- ❖ One-Year Preliminary Term Method (Generally)
- ❖ Defined Mortality Tables
- ❖ Limitations on Lapses and Interest Rates
- ❖ No Prescribed Morbidity Table

After Claim (Claim Reserves)

- ❖ PV Future Payments
- ❖ Include Incurred But Not Reported Claims
- ❖ Interest Rates by Incurred Year



So, Why Change?

- Current Statutory Standards include “lock-in”
 - reduces value of Frequent Review by the Actuary
- Value of Consistency with PBR within companies and with GAAP
 - Especially if interest assumptions change to reflect Spread Between the Valuation Rate and the Company Earned Rate
- Morbidity assumption/margin requirements within PBR



Potential Sources for Change

- NAIC Principles-based Approach (PBA) Rules being Developed for Life and Annuity Products
 - SVL-2 changes would include Health
 - Valuation Manual will need to provide requirements
 - Value of consistency with life/annuity requirements
- IAIS Principles-based Approach Using General Purpose Rules (With Adjustments) for All Types of Insurance
 - Coordinating with IASB/FASB
 - Using IAA Input



The Implications of the Five Principles on LTC Valuation

- Reserves reflect all material risks – already basis for gross premium valuation test
- Coordinates Valuation Model (Using Prudent Estimate) with Other Management Models
- Anticipates the Use of Company Experience and Recent Industry Experience for Key Assumptions
- Consistent basis for margins in Valuation Manual
- Could lead to coordinated reserve-capital calculations



Challenges

- Building a stochastic model incorporating the significant risks of a complex product
- Life/annuity CTE work limited to investment issues to date
- Lack of historical standard morbidity tables



Key Concerns for LTC Raised in 2006

1. How to reflect rate increase potential in future cash flows under varying scenarios.
2. Ongoing changes to LTC products and marketplace.
3. Differences between margins in rates and margins in reserves.
4. Ability to develop probability distributions for morbidity and persistency assumptions.
5. Anticipated use of company and industry experience.
6. Anticipated limits on interest rate assumptions.



So, Where Are We?



The Academy's LTC Principle-Based Work Group

Issue Subgroup

- Identify and Address PbA Issues for LTC
- Monitor and Provide Input on PbA Development for Life Products
- Monitor International Development

Technical Subgroup

- Specify Model Requirements
- Design, Develop and Test Model
- Monitor & Support LRWG and LRWG Modeling Subgroup
- Coordinate with SVL2 Economic Scenario Group
- Analyze Results



Technical Subgroup Update

- Led by Al Schmitz
- Discussions to date:
 - Design and Development of a test model
 - Reviewed variety of models available
 - Developed test model
 - Prefer an Excel-based model
 - Discussing different stochastic approaches
 - Maintain contact with Life groups



Issues Subgroup Update

- Led by John Timmerberg
- Discussions to date:
 - How do we define risk margins?
 - What level will they be?
 - How will they vary by business?
 - Investigating statistical distribution of claims
 - Developed an outline of issues to be investigated
 - Ongoing discussion on Life developments
 - Monitoring efforts relating to data availability for a morbidity table



Summary

- The discussions are now focusing on the mechanics and technical details.
- We are in the Model Selection Phase.
- Substantial work remains to be done.



What We Need From You



Feedback, Feedback, Feedback

- What are YOUR expectations of a principles-based approach for LTC?
- Given the current basis for principles-based (reserves and capital) for life/annuity, what components of that work do YOU think are appropriate for LTC?
- Given the distribution of new LTC business among a relatively few companies, how do YOU think industry/standardized assumptions can be established?



Questions?

