A PUBLIC POLICY PRACTICE NOTE

EXPOSURE DRAFT

Long-Term Care Insurance Compliance with the National Association of Insurance Commissioners Long-Term Care Insurance Model Regulation Relating to Rate Stability

April 2012

Developed by the Long-Term Care Practice Note Work Group
of the American Academy of Actuaries

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Comments are welcome as to the appropriateness of practice notes, desirability of annual updates, and substantive disagreements, etc. Comments should be sent to the Academy's State Health Policy Analyst, at StateHealthAnalyst@actuary.org.

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I. Introduction

Since the adoption of the Long-Term Care Insurance (LTCI) Model Regulation in 2003 by the National Association of Insurance Commissioners (NAIC) and its amendment in 2009, actuarial practice has developed to meet the responsibilities of the actuary. This practice note provides non-binding guidance to LTCI pricing actuaries when completing an actuarial certification related to pricing LTCI policy forms under the rate stability provisions of the model regulation (Sections 10 and 20). Actuaries retain sole discretion, however, to determine whether and how to take into consideration the guidance offered in this practice note.

Is the model regulation applicable to the practicing LTCI pricing actuary?

No. No model regulation is directly applicable until adopted by a state—and then only after its effective date. This practice note assumes adoption of the model regulation in its entirety. When pricing or repricing is not subject to Sections 10 and 20 of the model regulation, but is subject to laws or regulations specifying minimum loss ratios or related rating requirements (e.g., Section 19 of the model regulation), the practice note may not be applicable.

How does this practice note relate to Actuarial Standards of Practice (ASOPs)?

ASOP No. 18, *Long-Term Care Insurance*, was adopted by the Actuarial Standards Board (ASB) in January 1999, effective on or after June 1, 1999. It binds actuaries practicing in the United States who are "…involved in designing, pricing, funding, or evaluating liabilities for…long-term care (LTC) benefits." The actuary should continue to consult pertinent ASOPs for guidance relating to the pricing of LTCI plans, especially ASOP No. 18, which provides guidance for pricing LTCI. Some paragraphs from ASOP No. 18 that are particularly relevant to this practice note are included herein for the reader's convenience.

How is the LTCI pricing actuary to use the NAIC's LTCI Guidance Manual?

The NAIC has completed the *NAIC Guidance Manual for Rating Aspects of the Long-Term Care Insurance Model Regulation as amended in 2009)*. The guidance manual is intended to provide additional information on and interpretation of the model regulation for regulators. While it is not a legally binding document, the Purpose section of the guidance manual states that "it is anticipated that insurers will review this material in order that they make the filing process as expeditious as possible." Actuaries may refer to the guidance manual as appropriate in preparing the actuarial certification.

II. Overview of the Requirements on the Pricing Actuary

Initial premiums

The LTCI model regulation Section 10 presents a significant departure from LTCI Model Regulation Section 19 and from model regulations for other health products. Most significant is the absence of an initial loss ratio requirement applied to the insurer's form. LTCI model regulation Section 19 retains initial loss ratio requirements for policies issued prior to the effective date of Section 10. Instead of an initial loss ratio requirement, the actuary is required to provide a written certification that several conditions have been met. For example, Section 10.B.(2) requires:

"An actuarial certification consisting of at least the following: (a) A statement that the initial premium rate schedule is sufficient to cover anticipated costs under moderately adverse experience and that the premium rate schedule is reasonably expected to be sustainable over the life of the form with no future premium increases anticipated…"

Premium increase on in-force business

Another significant difference between the rate stability provisions of the LTCI model regulation and rate regulation for other health lines or older LTCI blocks is related to the requirements that the actuary must satisfy at the time of a request for a premium increase on in-force business. The requirements are different for business sold now than under the original LTCI model regulation Section 19 (single lifetime loss ratio requirement). The requirements of the current Section 20 include an actuarial certification (and a supporting actuarial memorandum) stating that the revised premiums are sufficient under "moderately adverse conditions" and no further in-force premium increases are anticipated. In addition to the certification, the actuary is subject to several other requirements, including:

- A requirement to justify the in-force premium increase through projections of claims and premiums.

- Disclosure of the original assumptions that were not met and that caused the rate increase request as well as other disclosures.

- Certification that the new premium schedule meets a loss ratio requirement on the original premium as well as the increase in premium.

The remainder of this practice note describes steps an actuary might choose to take when pricing LTCI products under the requirements of Sections 10 and 20 of the model regulation.

III. Process for Pricing Initial Premium Rates

One of the most significant requirements contained in the model regulation is the actuarial certification specified as part of the initial filing requirements in Section 10.B.(2). The actuarial certification includes at minimum the following:

> (a) A statement that the initial premium rate schedule is sufficient to cover anticipated costs under moderately adverse experience and that the premium rate schedule is reasonably expected to be sustainable over the life of the form with no future premium increases anticipated;
>
> (b) A statement that the policy design and coverage provided have been reviewed and taken into consideration;
>
> (c) A statement that the underwriting and claims adjudication processes have been reviewed and taken into consideration;
>
> (d) A complete description of the basis for contract reserves anticipated to be held under the form, to include:
>
>> (i) Sufficient detail or sample calculations provided so as to have a complete depiction of the reserve amounts to be held;
>>
>> (ii) A statement that assumptions used for reserves contain reasonable margins for adverse experience;
>>
>> (iii) A statement that the net valuation premium for renewal years does not increase (except for attained-age rating where permitted); and
>>
>> (iv) A statement that the difference between the gross premium and the net valuation premium for renewal years is sufficient to cover expected renewal expenses; or if such a statement cannot be made, a complete description of the situations where this does not occur;
>
> (e) (i) A statement that the premium rate schedule is not less than the premium rate schedule for existing similar policy forms also available from the insurer, except for reasonable differences attributable to benefits; or

(ii) A comparison of the premium schedules for similar policy forms that are currently available from the insurer with an explanation of the differences.

There are several steps an actuary may choose to take when preparing initial premium rates under the model regulation. These steps are described below.

1. Review product and management strategy of the company

Before setting assumptions or premium rates, the actuary may want to review the company's past experience in LTCI, if any, as well as its proposed product. This review typically would include discussions with company management. The purpose of this review is to give the actuary the necessary background for setting pricing assumptions if the actuary does not already have such background. The actuary should consider all applicable ASOPs. Particular ASOPs to consider are ASOP No. 18, *Long-Term Care Insurance*, and ASOP No. 25, *Credibility Procedures Applicable to Accident and Health, Group Term Life, and Property/Casualty Coverages.* However, this is not an exhaustive list.

Section 10.B.(2)(a) of the model regulation requires "a statement that the initial premium rate schedule is sufficient to cover anticipated costs under moderately adverse experience and that the premium rate schedule is reasonably expected to be sustainable over the life of the form with no future premium increases anticipated." In making this statement, the actuary is bound by the specific requirements of the model regulation and all relevant ASOPs.

The actuary, however, is not restricted only to consideration of factors such as morbidity, persistency, and interest. Section 10.B.(2)(a) allows considerable discretion in setting the specific assumptions for projected experience corresponding to sustainable premium rate schedules. In exercising this discretion, the actuary is required by the model regulation to set the initial premium rate schedule so that (a) the sustainable rates correspond to the projected adverse experience up to the moderate level; and (b) the premium rate scale does not have to cover projected adverse experience beyond the moderate level. The pricing actuary is to determine whether the insurer's perspective toward adverse experience, in combination with the actuary's own moderate level, provides sufficient grounds to reasonably expect that the premium rates will be sustainable over the life of the policy. The final determination of sustainability under moderately adverse deviations should be acceptable to the actuary, and the actuary would be advised to have the approval of the insurer's company management.

Some portions of the adverse experience may be addressed from sources not directly resulting from explicit margins in the pricing of the policy form for which the actuary is preparing the actuarial certification. The insurer, for example, may be willing to accept a lower profit level in the event of adverse experience, base any request for a rate increase on the experience of the form in more than just each state (i.e., offsetting poor results in some states with good results in other states), or even pool the experience of several policy forms. If the actuary is intending to use any of these sources in setting the sustainable premium level, the position of the insurer's product line management becomes critical so it can be documented as a source of margins for adverse experience (see the fifth bullet point below).

In setting the assumptions for sustainable premiums:

- The actuary might wish to review the insurer's product line management strategy. This may include a review of the line's overall profit expectations, as well as any significant deviations in profit expectations for each product series/generation, plan design option, issue age, and/or other relevant subdivisions of the line. It also may include a review of the processes and procedures the insurer has in place to enable it to identify, react to, and address emerging experience trends, whether positive or adverse.

- The actuary may wish to review the insurer's approach toward in-force premium increases to assess the conditions under which it would seek a rate increase. Is its objective to set initial rates sufficiently high that the possibility of in-force premium increases is remote? Is it generally unwilling to request premium increases even if poor experience emerges? Is it willing to accept lower profit margins to avoid in-force premium increases? Or will it want premium increases in the event that profit margins erode due to poor experience? Is it looking at profit margins for each policy form or for the LTCI product line in total?

- The actuary may wish to consider the company's marketing, administrative, and billing methods. For example, the actuary may wish to review the impact on morbidity, lapse, and expense assumptions of the insurer's marketing and sales approaches with respect to the use of individual, individual multi-life, or true group sales; captive or independent agents; agent training and practices; and direct marketing to potential applicants. Voluntary lapse rates, in particular, may vary significantly between business that is payroll-deducted, direct-billed, and employer-paid.

- The actuary may wish to consider the mix of business. Demographic data for actual sales versus targeted sales may be reviewed, especially to the extent that the target market is being changed. For example, if the target market moves to people in their 60s from people in their 70s, the actuary may wish to consider how the change in distribution mix will affect overall profitability.

  In cases in which unisex rates are being used, the actuary also may wish to review the gender mix of sales and remaining in-force business. In addition, company management may want the product to be more competitively priced in certain target issue age and product design cells, which could result in profit margins that vary by cell.

- The actuary may wish to review the insurer's experience and expertise with LTCI. What expertise does it have in different areas of administration? What are appropriate margins for deviation in assumptions, considering the insurer's level of experience and expertise?

- The actuary may wish to consider the effects of entering into various reinsurance treaties. The actuary typically would consider the effects in the following areas: surplus strain, using the underwriting expertise of the reinsurer, using the claims expertise of the reinsurer, and the credit risk of the reinsurer. In addition, the actuary may wish to consider the effects of any treaty provisions allowing the reinsurer to request a rate increase or to change expense allowances.

Listed below are specific requirements of the model regulation:

Section 10.B.(2)(b) of the model regulation requires "a statement that the policy design and coverage provided have been reviewed and taken into consideration." In conducting this review, the actuary may wish to consider issues such as the following:

- How does the proposed product design and policy form language compare with the company's existing LTCI forms?

- What assumptions will be affected by any product or language changes?

- What has been the insurer's experience on other LTCI policy forms?

- What is the insurer's morbidity, persistency/lapse, and mortality experience and investment yield history?

Section 10.B.(2)(c) of the model regulation requires "a statement that the underwriting and claims adjudication processes have been reviewed and taken into consideration." In conducting this review, the actuary may wish to consider the two processes separately.

- With respect to the proposed underwriting processes and guidelines, the actuary may wish to consider issues such as the following: How do these underwriting processes and guidelines compare with those used with other policy forms? What has been the insurer's experience on other policy forms with these underwriting processes and guidelines? Have there been changes in underwriting processes and guidelines? Or is this an insurer new to LTCI? (If so, a review of the experience of the underwriting staff's capability may be appropriate.)

- If the proposed underwriting processes and guidelines are not followed, there may be serious impacts on the long-term morbidity of the product line. Some actuaries believe that relatively loose or moderate underwriting practice results in claim frequencies that continue to trend above those of relatively tight underwriting, even after the expected select period otherwise would be over.

- With respect to the proposed claims adjudication processes, the actuary may wish to consider issues such as the following: How do these processes compare with processes used on other LTCI policy forms? What has been the insurer's experience on other policy forms with these claim adjudication processes? What will be the effect of case management strategies, if such strategies are used?

2. Set initial assumptions and premiums

Many actuaries may consider setting pricing assumptions only after reviewing the necessary product and management information. Under Section 10.B.(2)(a) of the model regulation, assumptions need to be set to satisfy the requirement "that the initial premium rate schedule is sufficient to cover anticipated costs under moderately adverse experience." The actuary, therefore, may decide to build margins into the pricing assumptions. This can be done in at least the three following ways:

a) Use best estimates for each assumption and add an explicit overall margin to satisfy the moderately adverse experience requirement.

b) Add sufficient margins to specific pricing assumptions so these margins in total would satisfy the moderately adverse experience requirement.

c) Otherwise establish appropriate margins. An appropriate margin, for example, might be established by using best estimate assumptions and pricing with a higher profit target than the insurer typically requires. For another example, the actuary may recognize that management is willing and able to accept losses or smaller profits before implementing a rate increase. This example may be appropriate for a variety of reasons, such as when management plans to restrict its LTC risk relative to other lines of business or allow another product to support the policy being issued. The certifying actuary is advised in such cases to communicate to management the potential short- and long-term implications of such pricing and to be diligent in documenting these implications and management's recognition of them.

Regardless of the method selected for setting margins, the actuary typically indicates whether the specific pricing assumptions represent best estimates or whether they include margins for moderately adverse experience. When setting the assumptions, the actuary may want to consider which assumptions are the most critical with respect to premium stability. The actuary may find it prudent to conduct sensitivity tests around the assumptions to understand the effect on profitability and premium stability. In addition, the actuary may want to examine how the key assumptions such as mortality, lapse, claims, and expense match the company's recent experience, as well as any changes needed resulting from the new product's benefit design, underwriting, and claim adjudication. In addition, the actuary may want to compare the investment income assumption with the company's investment strategy and expected future interest rates and cash flows under the new product. The actuary may find it prudent to advise the company on the importance of monitoring actual experience relative to assumptions, claims practices, and underwriting practices through feedback mechanisms if possible. As the valuation actuary is typically a part of feedback processes, it may be helpful for the actuary to provide a copy of the documentation to the valuation actuary.

More substantial and detailed analysis of each pricing assumption generally would be appropriate in situations in which the actuary includes future improvements (beyond currently observed levels) for one or more key assumptions. One such question regarding assumptions regards how to set the level of morbidity in future years relative to the level experienced by the company. The following example illustrates the level of inquiry that the actuary may consider for all assumptions:

An actuary is pricing a comprehensive LTCI product. In setting the morbidity assumption, the actuary is considering including a projection of anticipated future morbidity improvement as the best-estimate assumption. In this example, this assumption is based on published articles appearing in the peer-reviewed scientific literature that historically have demonstrated morbidity improvement in the general population.

The actuary also considers the impact of other relevant factors beyond the morbidity improvement in setting this assumption. These factors include:

- The underlying source of the morbidity improvement and the effect that the underlying source may have on other assumptions (e.g. mortality). Mortality and morbidity improvements, for example, often are thought to go hand-in-hand. If improvements cannot be shown in both areas, or if results are not conclusive, the actuary may want to consider either not including expected improvements or limiting the number of years of improvements.

- The actuary’s assumption that anticipated future improvements will be due to reduced claim frequency, and the actuary’s belief that the future improvements could be offset partially by related improvements in longevity and/or changes in claim continuance patterns.

- Increased use of alternate plans of care.

- The potential for increased future utilization and claim continuance, and increased volatility of both, at the highest ages.

- Differences between the insured population and the general population.

In this case, in determining the margin for moderately adverse experience, the actuary considers the effect of not realizing the morbidity improvement assumed as well as the effect of adverse experience related to the other factors listed above.

If the source of all margins is not from the policy form being priced, the actuary would be prudent to verify that the margins for moderately adverse experience built into the premiums are consistent with the company’s product line management strategy when determining these initial premium rates. If the product line management strategy is to accept lower profit results in the event of adverse experience, the pricing margins added to cover moderately adverse experience may be smaller than those needed for a company that anticipates increasing premiums in the event of adverse experience.

3. Test the margin for moderately adverse experience

Section 3.5 of ASOP No. 18 requires the actuary: "to perform sensitivity testing of reasonable variations in assumptions." As part of this testing, the actuary may wish to determine how much variation could be experienced in key pricing variables before an in-force premium increase would be requested.

Once premium rates are determined, the actuary typically tests the margin built into pricing for moderately adverse experience. This is done to determine the degree to which the actual experience of significant pricing assumptions could vary from the expected levels before an in-force premium increase may be needed or requested. The margins are stated relative to the actuary's best estimate assumptions, which may be different from the company's requested pricing assumptions or the proposed reserving assumptions.

To test the adequacy of margins, the actuary first may determine the key variables for testing based on how sensitive the pricing results are to changes in these assumptions. The specific variables to test may vary from company/product to company/product based on experience and product design. Some of the key variables that the actuary may wish to consider, however, typically are morbidity (incidence/continuance/cost), mortality, voluntary lapse, and investment returns.

In testing the margin for moderately adverse experience, multiple scenarios of adverse experience may be tested. There are two commonly used structures for the scenarios to be tested. The structures differ by how the scenarios test the margins for each of the pricing assumptions: morbidity, mortality, lapse, and investment yield.

The first commonly used structure tests adverse experience separately for each of the assumptions. This can be illustrated as w percent of morbidity, or x percent of mortality, or y percent of lapse, or z percent of investment yield.

The second commonly used structure tests adverse experience for all of the assumptions concurrently. This can be illustrated as w' percent of morbidity, and x' percent of mortality, and y' percent of lapse, and z' percent of investment yield.

In determining the number of scenarios to test and the level of adverse experience to test, the actuary may consider:

Credibility of each of the best estimate assumptions—The lower the credibility of each of the best estimate assumptions, the actuary may consider testing

(1) a greater number of scenarios, and

(2) a broader range of adverse experience.

The actuary should conform to the guidance in ASOP No. 25, *Credibility Procedures Applicable to Accident and Health, Group Term Life, and Property/Casualty Coverages*, or document any deviation from the standard.

Mix-of-business assumptions—Assuming that the margins being tested are not equivalent for all pricing cells, the actuary may test potential distributions different from the best estimate.

Change-over-time assumptions—The actuary may consider the assumptions for which experience is likely to change materially over the lifetime of the LTC policies.

Management strategy—The actuary may consider the company product line management strategy in choosing scenarios and margins to test.

4. Company review and agreement

Once premium levels that satisfy the requirements necessary for making the actuarial certification are determined, the actuary usually would review the pricing work with an appropriate level of company management. This review typically would include a review of all of the actuary's assumptions relating to product design, underwriting, and claims adjudication, as well as the strategy for management of the product line. The actuary may want to point out how these assumptions affect premium levels, including the pricing effect of several tests showing how the premium rates and future profitability objectives would be affected in the event actual experience differs from expectations. In addition, the actuary may want to describe the level of moderately adverse experience used in making the actuarial certification.

The pricing actuary also may review the work with the valuation actuary to ensure compliance with the aspects of the certification that relate to reserve levels and to communicate all best-estimate assumptions—as well as margins for moderately adverse experience—to the valuation actuary, who may request this information to establish reserves.

Consistent with ASOP No. 18, Section 3.7, the actuary should recommend that the company review experience on an ongoing basis to identify areas in which experience emerges differently from what was assumed in initial pricing.

5. Documentation

The actuary should document appropriately the work done in support of the initial pricing and actuarial certification. ASOP No. 18, Section 4.1 states: "Because an LTC insurance plan is expected to remain in force over a very lengthy period of time, all assumptions are subject to review and update on a regular basis. Therefore, the actuary should document the assumptions, processes used, and the general sources of the data in sufficient detail such that another actuary could use the documentation where appropriate."

Some actuaries will provide this documentation to the company with a recommendation that it be retained for the life of the policy form. Others may retain the documentation with the actuary's employer.

In some instances, it may be preferable for both the company and the actuary's employer (if different) to keep copies of the documentation. The documentation provided in support of the initial pricing and actuarial certification also may be requested in the event that a future rate increase is necessary. In the event a company purchases a block of LTCI business priced under the model regulation, regulators may expect the purchasing company to be familiar with the actuarial support for the premium rates.

Specific documentation could include, for example:

- An actuarial memorandum documenting assumptions used in setting the initial premium levels.

- A description of the valuation basis for active life and claim reserves may be included. It may be helpful to include a sample calculation for the base policy active life reserve and all riders.

- An analysis showing that the difference between the gross premium and the net valuation premium is sufficient to cover expected renewal expenses as required by Section 10.B.(2)(d)(iv). In those situations in which the actuary cannot make the statement required in Section 10.B. (2)(d)(iv) of the model regulation, the actuary may want to include a description of the adjustments to the reserving assumptions that would allow the actuary to make the statement (e.g., an increase of 1 percent in the interest rate for issue ages under 60).

- A comparison of gross premiums of the plan being filed to gross premiums on other policy forms, if any, the company offers. When the actuary has done an analysis in relation to the requirements of Section 10.B.(2)(e)(ii) of the model regulation, the actuary might include a description of differences in assumptions appropriate to this form or other forms.

- An actuarial certification used for the initial filing.

- A description of the assumptions made with respect to underwriting and claims adjudication. The actuary may want to document what underwriting information is gathered at various ages and the underwriting decisions that are made with that information. The actuary also may want to document details about the claims adjudication, such as the process used to determine eligibility and how often claims are reviewed. The actuary may wish to include a reliance statement from individuals responsible for these areas, when necessary, in the actuary's judgment.

- Documentation of the sensitivity analysis performed on the moderately adverse experience certification, along with other assumptions made about this analysis not contained in the actuarial memorandum. This documentation typically would include the actuary's assumptions about the product line management's strategy for rate increases if any portion of the margin for adverse experience is assumed to be covered by sources other than the form itself. When necessary in the actuary's judgment, the actuary may wish to include a reliance statement from the individual responsible for product line management regarding the assumptions related to the company's premium increase strategy.

- The actuary may reference the latest copy of the *NAIC Guidance Manual for Rating Aspects of the Long-Term Care Insurance Model Regulation (as amended in 2009)* for additional items to include in the documentation. These items appear as the Actuarial Memorandum Checklist under Appendix 5.

How is "moderately adverse experience" defined?

The model regulation does not define "moderately adverse experience," nor is that exact phrase defined in any ASOP. The regulation puts the responsibility of determining and certifying to the adequacy of premiums under "moderately adverse experience" on the pricing actuary.

The specified amount of margin for moderately adverse experience usually will vary by assumption(s) and by company, based on many possible factors, including:

- The actuary's interpretation of "moderately adverse experience."

- The actuary's confidence in and credibility ascribed to the underlying assumptions.

- The sensitivity of pricing results to variations in the assumptions.

- The actuary's judgment of the effect of combinations of various assumptions, their degree, and the likelihood of being adverse.

- The company's tolerance of adverse financial results before considering an increase of in-force premiums.

Is there a distinction between the phrases "premium rate schedule is sufficient to cover anticipated costs under moderately adverse experience" and "premium rate schedule is reasonably expected to be sustainable over the life of the form with no future premium increases anticipated" that the actuary is required to certify to in the actuarial certification?

Some pricing actuaries view these two phrases as essentially the same. If rates are sufficient to cover anticipated costs under moderately adverse experience, these actuaries believe that the rates reasonably can be expected to be sustainable over the life of the form with no future premium increases anticipated.

Other actuaries are convinced that the “reasonably expected to be sustainable” phrase clarifies the intent of the “moderately adverse experience” phrase. These actuaries note that an actuary could consider only deviations in individual pricing assumptions when determining whether premium rates are sufficient to cover moderately adverse experience. These actuaries believe that the intent of the phrase “reasonably sustainable over the life of the form with no future premium increases anticipated” is to consider the possible effects of deviations in more than one assumption. In this case, the actuary typically considers that no future premium increases are anticipated unless the compounding effect of deviations in multiple assumptions exceeds the most significant moderately adverse deviation in an individual pricing assumption tested.

The model regulation requires the individual pricing actuary’s certification when pricing rates to include both phrases above.

To what extent does the model regulation require the actuary to review the underwriting and claims adjudication processes? Is it appropriate for the actuary to rely on other professionals?

The model regulation requires the actuary to review the underwriting and claims adjudication processes and guidelines used by the company. It further requires the actuary to consider these processes and guidelines in developing the actuarial certification. The actuary may rely on appropriate individuals to review the described underwriting and claims adjudication processes and guidelines. The actuary then would select pricing assumptions that are consistent with the processes and guidelines as described. An outline of the type of documentation the actuary might provide is included in Section V of this practice note.

Are there any loss ratio considerations?

While there are no loss ratio requirements at the time of initial filing, the actuary may consider the potential impact of the loss ratio requirements that would be applied in the event of a premium increase on in-force business subject to Section 20 of the model regulation. Under Section 20, if such an increase is required, the initial premium will be subjected to a 58 percent loss ratio.

Section V of this practice note addresses the specific implications for loss ratios on premium increases for in-force business.

How might the actuary address conservative reserve assumptions that do not meet the model regulation’s

certification criteria that the difference between the gross premium and net valuation premium for renewal years is sufficient to cover expected renewal expenses?

Some companies may decide to establish conservative reserves (e.g., with a 0 percent voluntary lapse assumption), such that the difference between the gross premium and the net valuation premium is less than the expected renewal expenses. The model regulation (further amplified in the *NAIC Guidance Manual for Rating Aspects of the Long-Term Care Insurance Model Regulation as amended in 2009*) allows the actuary to provide a description of the situations in which this occurs and to demonstrate the type and level of change in reserve assumptions that would be necessary for this certification to be made. Under this approach, the actuary usually would document the level of conservatism in the reserve assumptions, along with the above demonstration. In the event that the above demonstration relies on assumptions that appear aggressive (unreasonable?) to the regulator, the actuary may be called upon to supply additional information or to revise his/her gross premium rates.

If the actuary uses adjusted assumptions (modifications to the reserve assumptions described in the actuarial certification), do these become the assumptions for contract reserves?

These adjusted assumptions typically are used only for purposes of completing the statement in the actuarial certification required by Section 10.B.(2)(d)(iv) of the model regulation.

IV. Process for Preparing Premium Rate Increases for In-force Policies

The model regulation places requirements on the actuary in the event an in-force premium (rate) increase is requested. These requirements include an actuarial certification, loss ratio requirements on premium rate increases (different requirements on the initial premium and the premium increase), and additional disclosures.

All of the requirements for in-force premium increases are contained in Section 20 of the model regulation. Section V of the practice note describes possible approaches to meeting the requirements of Section 20 of the model regulation. Other approaches also may be appropriate.

There are several steps an actuary may choose to take when determining increases on in-force premiums that are subject to Section 20 of the model regulation. These steps are described below. Note that these steps assume the policy being considered for an increase of in-force premiums was originally priced under the requirements of Section 10 of the model regulation:

1. Review original filing material

Section 20.B.(3)(c) of the model regulation requires the actuary to review original material and become familiar with the initial actuarial certification and related documentation. In the event the actuary is pricing a second or additional later rate increase, the use of the term "original" throughout this section refers to the previous filing. Specific items to examine may include:

- What were the original pricing assumptions?
- What were the assumptions regarding underwriting and claims adjudication?
- What were the assumptions regarding marketing, distribution, and the mix of business?
- What was the product line management strategy with respect to profitability in the event of adverse experience?
- What were the moderately adverse conditions (e.g., moderately adverse experience) identified at the time of the original filing?

In addition, consistent with the requirements of Section 20.B.(3)(a) of the model regulation, the actuary should review the pricing assumptions of the company's other LTCI forms currently available for sale. Deviations in the assumptions used for any rate increase from those used for these other forms are required by the model regulation to be reflected within the actuarial memorandum.

2. Review experience to identify sources of adverse experience

Once the actuary is familiar with the assumptions used for the original pricing, the actuary typically analyzes the experience to date to determine the sources of adverse experience. For example, if the need for an in-force premium increase is being driven by higher-than-anticipated claim experience, the actuary might look into the underlying source of these deviations.

Some examples of sources of adverse experience could be:

- Longer lengths of claim benefit periods resulting from higher-than-anticipated numbers of cognitive claims, due to inadequate underwriting.
- Higher costs of services than anticipated because anticipated savings resulting from case management were not realized.
- Higher-than-expected claims payments due to higher-than-anticipated persistency.

Consistent with Section 3.2.1 of ASOP No. 18, the actuary should consider the degree of credibility of the data from the entity when determining whether an in-force premium increase is necessary. When non-credible actual experience data from the entity differs from the expected results, the actuary may wish to compare expected results with other sources of current experience, appropriately adjusted (e.g., for differences in benefits and underwriting requirements).

Consistent with the requirements of Section 20.B.(3)(c) of the model regulation, when analyzing the company's experience and determining the sources of adverse experience, the actuary should consider whether the adverse experience is being caused by company-specific sources (e.g., inadequate underwriting, poor claims management, unexpected sales mix of business) or by industry-wide experience (e.g., longer average lengths of claims due to improvements in longevity and medical technology, higher-than-anticipated costs due to higher-than-expected increases in LTC services). Finally, the actuary usually considers whether the adverse experience can be expected to continue, intensify, or decrease in the future.

3. Determine if the rate increase is an "exceptional increase"

Once the source or sources of the adverse experience is determined, the actuary typically determines whether the need for an in-force premium increase meets the definition of an "exceptional increase." The definition of "exceptional increase" and how it is to be addressed is explained in Section 4.B.(1) of the model regulation as:

> Exceptional increase means only those increases filed by an insurer as exceptional for which the commissioner determines the need for the premium rate increase is justified:
>
> (a) Due to changes in laws or regulations applicable to long-term care coverage in this state; or
> (b) Due to increased and unexpected utilization that affects the majority of insurers of similar products.

As with any pricing analysis under the model regulation, the actuary might consider documenting any development that may be exceptional for use at a later date.

4. Compare original risk margins and adverse experience

Once the actuary has analyzed the experience and determined the source(s) of adverse experience, the actuary then may compare the experience to the moderately adverse experience defined at the time of original pricing to determine if the actual experience exceeds the original assumptions including margins for moderately adverse experience. When comparing actual experience to moderately adverse experience, the actuary also may consider, for example:

- Has adverse experience in one assumption been offset by better-than-anticipated experience in other assumptions?

- Has the product line management strategy documented at the time of original pricing been appropriately reflected in the comparison?

If the actual experience is not in excess of the moderately adverse experience defined at issue, regulators may be unwilling to approve an increase in in-force premiums.

Section 20.B.(3)(c) of the model regulation requires: "Disclosure of the analysis performed to determine why a rate adjustment is necessary, which pricing assumptions were not realized and why, and what other actions taken by the company have been relied upon by the actuary." Some actuaries may interpret this section to include a comparison showing how actual experience has exceeded the moderately adverse experience certified at the time of the original filing. The actuary may consider advising the company about the appropriateness of developing and preserving such documentation.

5. Calculate new premium schedule

Once the actuary has determined that an in-force premium increase is needed based on actual experience and margins for adverse experience, the actuary may calculate the new premium schedule. As part of the new premium rate schedule filing, the actuary will be required to provide a new actuarial certification.

Section 20.B.(2) of the model regulation specifically requires:

> Certification by a qualified actuary that:
>
> (a) If the requested premium rate schedule increase is implemented and the underlying assumptions, which reflect moderately adverse conditions, are realized, no further premium rate schedule increases are anticipated;
>
> (b) The premium rate filing is in compliance with the provisions of this section. (i.e., Section 20 of the model regulation).

Consistent with Section 20.B.(3)(d) of the model regulation, in calculating the increased premium, the actuary should consider any changes that are being made to the product. In particular, the actuary typically takes into account the policy design, underwriting, and claims adjudication that may affect future experience. The actuary also may consider any known material changes in the product line management strategy being implemented as part of the premium increase.

Once the necessary product and management information has been reviewed, the actuary sets revised assumptions. In addition to the issues considered in Section III of this practice note for determining initial premium rates, the actuary also might wish to consider, for example:

- The effect of shock lapses, election of reduced benefit options, and anti-selection that may result from the in-force premium increase.

- The impact of any known material changes in policy design, underwriting, claims adjudication, or management strategy.

- The cost of any benefits resulting from the contingent benefit upon lapse benefit, if applicable.

- The impact of the loss ratio requirements that are applied to the premium rate schedule.

- Whether the rate increase is recouping past losses.

- Changes needed to the statutory reserve basis to allow the valuation actuary to establish reserves with appropriate margins and the possible need for premium deficiency reserves.

Similar to the initial premium rate schedule, the model regulation requires revised premium rates to be sufficient under moderately adverse conditions. The actuary, therefore, may build in margins to the revised premium rates by a process similar to that done at the time of initial pricing.

Once the revised premium rate schedule is set, the actuary typically performs appropriate tests to ensure that the rate schedule is in compliance with the model regulation. Consistent with the requirements of Sections 20.B, C, and G, these tests include:

- Testing the margin for moderately adverse experience. This testing is similar to that done at the time of original pricing. In light of the actual experience, the actuary may reconsider the level of margin necessary to certify adequacy under moderately adverse experience. In addition, the actuary may reconsider the specific variables that need to be tested.

- Testing the renewal premium schedule to determine if it is greater than new business premium rate schedules, except for differences attributable to benefits.

- Testing the premium rate schedule for compliance with the loss ratio requirement. Unless the in-force premium increase meets the requirements of an exceptional increase, the loss ratio requirement is that the present value of incurred claims must not be less than 58 percent of the present value of initial premium and 85 percent on the increase portion. For exceptional rate increases, the requirement to be met is 70 percent on the increase portion of the premium. For exceptional increases, there is no loss ratio requirement on the initial premium rate level. (Consult Section 20.C of the model regulation for specific calculation rules relating to the loss ratio requirements.)

- Testing if a majority of policyholders are eligible for the contingent benefit upon lapse (CBUL) as required by Section 20.G. The guidance manual (Section VI.D) clarifies that if the insurer voluntarily offers the CBUL, then this test should be interpreted to mean only those that must be offered the CBUL as required by Section 28 of the model regulation.

The actuary may identify the best estimate results and the margins for moderately adverse experience by putting explicit margins into some or all of the assumptions or by a different method previously described. The assumptions, including margins for moderately adverse experience, are to be used in determining compliance with the loss ratio requirements (58 percent / 85 percent or 70 percent per above).

6. Conduct company review and agreement

Similar to the review done at the time of initial pricing, the actuary generally reviews the pricing work with company management. This work typically includes discussion of the sources of adverse experience and any changes made to the assumptions relating to product line management or margins for adverse experience. It also typically refers to and discusses prior as well as current company and management intentions about future possible premium increases.

The actuary also may consider communicating to the valuation actuary any increases to premiums on in-force business and the assumptions used.

7. Produce documentation

Upon completion of the pricing and the actuarial certification, Section 4.1 of ASOP No. 18 requires the actuary to produce documentation to support the pricing work. This documentation is usually similar to that produced in support of the initial pricing and actuarial certification but includes additional information in the actuarial memorandum, as described in Section 20.B.(3). This documentation generally would be maintained over the life of the policy form. If a company purchases a block of LTCI business priced under the model regulation, regulators may expect the purchasing company to be familiar with the actuarial support for the premium rates.

8. Ensure experience monitoring is in place

Once an in-force premium increase is implemented, the model regulation contains several provisions that require annual monitoring and reporting of experience. These requirements are described in Sections 20.D, E, F, G, and H of the model regulation, although some of the provisions only apply to larger or more frequent premium increases. Consistent with Section 3.7 in ASOP No. 18, the actuary should consider whether the monitoring system is in place and may wish to make management aware of the implications of these provisions when preparing the reports.

Section 20.D of the model regulation states:

> For each rate increase that is implemented, the insurer shall file for review [approval] by the commissioner updated projections, as defined in Subsection B.(3)(a), annually for the next three (3) years and include a comparison of actual results to projected values. The commissioner may extend the period to greater than three (3) years if actual results are not consistent with projected values from prior projections. For group insurance policies that meet the conditions in Subsection K, the projections required by this subsection shall be provided to the policyholder in lieu of filing with the commissioner.

When providing the required information, the actuary may consider:

- Providing a copy of the original actual experience and projections that were submitted in the rate increase filing.
- Displaying the updated actual experience and projections in a similar format as the original projections or explaining any differences.
- Using the same number of years in the updated information as in the rate increase filing. If the original period reflected 50 years (10 historical and 40 projected), for example, then the updated information also would reflect 50 years but would include 11 years of history and project 39 years.
- Reflecting any changes in the assumptions used in the updated projections, and disclosing the changes relative to the original projections and/or the previous updated experience filing.
- Comparing the actual results to projected values (e.g., earned premium, incurred claims, and loss ratios) for the one additional year of experience and/or on a lifetime basis.
- Stating that the actual results are not expected to equal the original projected values when the original projected values include moderately adverse conditions. If an improved comparison is desired, then adjust the actual or original projected values so that both either include or exclude moderately adverse conditions.
- Separating any new issues from the in-force business used in the rate increase filing.

The specifics for the required information are not defined in the model regulation. The guidance manual, however, provides some clarification in Section VII, which is in the part reflected in the above considerations.

Do margins for moderately adverse experience have to be at the same level for an in-force premium rate increase as they were for original pricing?

The margins for moderately adverse experience do not necessarily have to be the same for a premium increase filing as they were for the original filing. Consistent with Section 20.B. (2)(a) of the model regulation, the appropriate margin at the time of a rate increase is based on the actuary’s judgment, given the information available at the time of the premium increase filing. The margin for moderately adverse experience needed at the time of the premium increase may be greater than or less than that included at the time of the initial filing.

This does not necessarily mean that regulators will approve a proposed rate increase that includes increased margin for moderately adverse experience from the level in the original pricing assumptions.

What if adverse experience is, at least in part, the result of lower-than-expected investment returns?

Regulators in various jurisdictions may have different views of the extent to which laws and regulations allow adverse experience due to shortfalls in investment returns to be used as a justification for filing for rate increases.

If a requested rate increase is partly or entirely due to adverse investment experience, the actuary may wish to consider:

- Recording the extent to which the adverse investment experience was due to the individual company's investment strategy and/or was due to broader economic circumstances.

- Defining the extent to which adverse historical investment returns is expected to continue.

- Documenting the company's past and future investment strategy and disclosing it to the regulators at the time of the rate increase request.

- Defining and disclosing the moderately adverse investment experience that would call for a further rate increase request.

What considerations arise in providing a certification that no further premium rate increase is anticipated for which the premium rate increase is limited either by the loss ratio requirement or by new business rates?

In addition to requiring a certification that "if the requested premium rate schedule increase is implemented and the underlying assumptions, which reflect moderately adverse conditions, are realized, no further premium rate schedule increases are anticipated," the model regulation has two requirements that may limit the rate level that results from a rate increase.

First, the regulation imposes a loss ratio requirement on premiums at the time of a rate increase. The anticipated lifetime present value of incurred claims must be at least 58 percent of the anticipated lifetime present value of premiums at the original rate level, plus 85 percent of the anticipated lifetime present value of rate increase premiums—

unless the increase qualifies as an exceptional increase. The present value must be calculated using the maximum valuation interest rate for contract reserves.

Second, the regulation requires a statement that “renewal premium rate schedules are not greater than new business premium rate schedules except for differences attributable to benefits, unless sufficient justification is provided to the commissioner.”

In some situations, an actuary may believe that the rate level needed to certify that no further premium rate schedule increases are anticipated is greater than the rate level allowed by either the loss ratio requirement or by the limitation to new business rate levels. In these situations, the actuary may be unable to certify that no further rate increases are anticipated while at the same time complying with the loss ratio requirement and new business rate level limitation.

In the case of the loss ratio limitation, the actuary, together with the company management, may consider the following:

- The certification asks the actuary to state that assumptions reflect moderately adverse conditions. If the actuary reflected moderately adverse conditions by putting explicit margins into some or all of the assumptions used to calculate compliance with the loss ratio requirement, including this margin may enable the actuary to meet the loss ratio requirement and make the required certification.

- If the actuary originally had chosen to reflect moderately adverse conditions by a different method, such as establishing a higher target profit level, he or she instead may consider building margins directly into the assumptions used to demonstrate compliance with the loss ratio requirement, as noted in Section VI.A.4 of the guidance manual.

- If the current rate increase request is the maximum allowable under the loss ratio requirement, then no further rate increases are possible if future experience does not develop as more than moderately adverse. This may enable the actuary to make the required certification under a rate increase request equal to the maximum allowed, even if additional rate increases may have been anticipated in the absence of the loss ratio requirement.

- A modification to the profit expectation such that the rate increase meets the loss ratio requirement and allows for the certification.

- A request for a rate increase (1) needed to make the certification and disclose that requested rate increase does not meet the loss ratio requirement or (2) that meets the loss ratio requirement and include a qualified certification (e.g., the rate increase may not be sufficient to prevent further rate increases).

In the case of the new business rate level limitation, the regulation allows that rates may be greater than new business rates if sufficient justification can be provided. If the actuary believes that a rate level greater than new business rates is needed to provide certification that no further increases are anticipated, the actuary, together with the company, may consider the following:

- Reviewing the comparison of in-force and new business rate levels in light of the distribution of business if the increased rate level would exceed new business rates only for some cells. The actuary, for example, could review average rate levels or the portion of existing business for which rates would exceed new business rates and include this information as part of justification for rates in excess of new business rates for some cells.

- Evaluating whether underwriting standards or rating classifications, including spousal or other discounts, have changed materially over time and examining the resulting effect on claim and rate levels. The results would be disclosed as part of the justification for rate levels higher than new business rates.

- Comparing the proposed increased rates to new business rates at the higher attained age for existing insureds affected by the increase, as noted in Section VI.A.5 of the guidance manual. It also is noted in the manual that this "may not be a sufficient reason to allow deviation from the standard."

- Conducting a review of new business rate levels in situations in which revised rates will exceed new business rates, even after considering the above.

- Modifying the profit expectation such that the rate increase meets the new business rate level limitation and allows for the certification.

- Requesting the rate increase (1) needed to make the certification and disclosing that the requested rate increase does not meet the new business limitation or (2) that it meets the new business limitation and includes a qualified certification.

If any of the above situations results in a requested rate level less than what originally was considered, the actuary may consider recommending to management that a review of the impact from this limitation be completed.

Some approaches above may not be acceptable in all jurisdictions.

What if the company prefers to not request the full single in-force premium rate increase needed?

At the time of the rate increase filing, Section 20.B.(2)(a) of the model regulation requires the actuary to certify the following:

> If the requested premium rate schedule increase is implemented and the underlying assumptions, which reflect moderately adverse conditions, are realized, no further premium rate schedule increases are anticipated.

In some cases the company may prefer not to request the full single rate increase necessary to make such a certification. In this circumstance, the actuary, together with the company management, may consider, for example:

- Filing for a tiered rate increase (e.g., X percent in the current year, additional Y percent in one year). One actuarial certification could then be made based on the implementation of all increases.

- Filing for less than the full rate increase, but with modified profit expectations such that the certification can be made.

- Filing for less than the full rate increase with a qualified certification (e.g., this rate increase will enhance premium adequacy, but may not be sufficient to prevent further rate increases; rates, therefore, cannot be certified as required by Section 20.B.(2)(a)) and disclosing to the department of insurance (DOI) the full rate increase needed and why it was not requested.

If less than the full single rate increase is to be implemented, the actuary may consider recommending to management that a review of the impact from this limitation be completed.

Some examples may not be acceptable in all jurisdictions.

What if the (DOI) does not allow the full single in-force premium rate increase needed?

Suppose a company requests the full single rate increase needed, along with the required certification of Section 20.B. (2)(a), but the DOI does not allow it. In this circumstance, the actuary, together with the company management, may consider gaining an understanding the DOI's reason and then, for example:

- Accepting a reduced rate increase, without providing a revised certification. This implies that the original certification was applicable only to the requested rate increase and that further rate increases may be anticipated given that less than the full amount is to be implemented.

- Accepting a reduced rate increase, along with a statement that the original certification no longer can be made given that less than the full amount is being implemented and a revised, qualified certification.

- Accepting a reduced rate increase, with modified profit expectations such that the certification still can be made.

- Providing additional justification for the full single rate increase. If the company is unwilling to accept a reduced rate increase, then the DOI may disapprove the rate increase.

- Proposing a tiered rate increase. One actuarial certification then could be made based on the implementation of all increases. Some DOIs may not allow a tiered rate increase. If the DOI allows only the first increase, then possibly consider the above alternatives.

If less than full single rate increase is to be implemented, the actuary may consider recommending to management a review of the impact from this limitation.

Some examples may not be acceptable in all jurisdictions.

What considerations may arise when an in-force premium rate increase is sought on a block that has both policies issued under the loss ratio regulation and those issued under the rate stability regulation?

Some LTC blocks crossed over the effective date of the model regulation, and therefore have policies issued under both the loss ratio regulation (Section 19) and the rate stability regulation (Sections 10 and 20). If a premium rate increase is sought, the actuary, together with the company management, may consider the following options:

- Subject all policies to the loss ratio regulation;

- Bifurcate the block between loss ratio and rate stability regulation by issue date;

- Apply the loss ratio regulation and the rate stability regulation to the entire block; or

- Apply only the rate stability regulation to the block.

Some of the above options may not be acceptable in all jurisdictions.

In deciding which option to follow, the actuary, along with the company, may consider:

- Circumstances of the particular jurisdiction. Some jurisdictions, for example, may have required companies to file a new certification subject to rate stability regulation before continuing to issue additional policies.

- The size of the block issued in a particular jurisdiction after the effective date of rate stability regulation.

- Disclosing the rationale for the approach chosen.

For these blocks that crossed over from the loss ratio regulation to the rate stability regulation, the rate stability certification and/or defining moderately adverse experience may not have been completed as of the effective date of rate stability regulation. The actuary, together with the company management, may consider defining the original profit expectations and moderately adverse experience based on expectations at the time of (a) the effective date of rate stability regulation or (b) the rate increase.

What considerations may arise relative to the monitoring requirement if the full single in-force premium rate increase needed is not implemented?

For each rate increase that is implemented, Section 20.D. of the model regulation requires that the insurer shall "file for review [approval] by the commissioner updated projections, as defined in Subsection B (3)(a), annually for the next three (3) years and include a comparison of actual results to projected values…"

If the full single rate increase is not implemented, the actuary may consider:

- Treating the approval for a tiered rate increase (e.g., X percent in the current year, additional Y percent in one year) as (a) one increase and providing the required information for three years or (b) multiple increases and providing the required information for three years after implementing each.

- Providing the required information after implementing each rate increase if the company requests additional rate increases until the full increase is implemented, for a minimum of three years, and/or using the rate increase filing(s) as the required information. Once the full amount is implemented or the company decides no longer to request additional increases, providing the required information for up to three additional years.

- Revising the original projected values to reflect the implemented (versus requested) rate increase for comparison with actual values.

- Disclosing to the DOI the company's plan relative the monitoring requirement.

Some approaches may not be acceptable in all jurisdictions.

V. Reporting Requirements for Rate Filings and Certifications

Actuarial reporting is required under different circumstances: initial filing, rate-increase filing, and, in some jurisdictions and with the Interstate Insurance Product Regulation Commission, for annual rate filings. Filing a rate increase may lead to additional filings.

Sections 10 and 20 of the model regulation contain filing requirements. Section 10 contains requirements for an initial filing. Section 20 contains requirements for filing an increase for premium rates.

Section 20.D. requires that updated projections be filed annually for review for each of the three (3) years after a rate increase. The model regulation requires that these projections include a comparison of actual results to projected values and states that the three-year period may be lengthened. If a rate increase results in a premium rate schedule greater than 200 percent of the comparable initial rate schedule, Section 20.E. requires that updated projections be filed for review every five years after the end of the three years of annual reporting.

Both of the requirements of Section 20.D and 20.E compare the experience to the previously projected values.

With regard to complying with Sections 10 and 20, annual rate filings, and the documentation requirements of Section 4.1 in ASOP No. 18, consideration may be given to various items relating to the initial filing assumptions, the underlying data collected, and the determination of assumptions for projections of future experience. For example, some actuaries may consider the following items:

- Whether rates initially were filed nationally or by jurisdiction, when defining class; the appropriateness of combining blocks with different benefits or underwriting requirements; and variances in the length of the premium paying period or the length of any rate guarantee.

- What may be the cause of a potential rate increase. For example, is only one benefit causing the need for a rate increase? Or is a more broad assumption causing the need for the rate increase? Other items that may be considered are the remaining time period for the application of the increased rate as well as anticipated policyholder behavior to the rate increase.

- What moderately adverse circumstances would be for an initial filing. And for a rate increase filing, whether the margin for moderately adverse experience should be adjusted as well as the extent to which a provision for moderately adverse experience may be applied and how the loss ratio requirement encompasses the margin.

- What is the method of calculation and any approximations (i.e., calculations not made from first principles) that include implicit margins. Such consideration may address how any such approximation will be handled if the need for a rate increase arises.

- What is the method of developing assumptions for active-life, disabled-life, or aggregate lives. In addition, the method of calculating exposures.

- What claim-termination rates and parameters are used to derive termination rates.

- Whether claim reserves reflected in deriving the reported incurred claims or claim experience are sufficient as well as the reasonableness of the claim reserve pattern.

- What assumptions are used by the valuation area in performing the gross premium valuation.

- What are loss ratios at a) initial filing, b) prior to any rate increase, c) to the rate-increase portion of the new rate, and d) after any rate increase. Also, what are loss ratio actual-to-expected ratios, both before and after the rate increase.