Session 183 PD - What’s New With LTC? A Regulatory and Product Development Update on the LTC Industry

Moderator:
John Bach Hebig, FSA, MAAA

Presenters:
Peggy L. Hauser, FSA, MAAA
John Bach Hebig, FSA, MAAA
Nicole Pittman, ACS, CLTC, J.D., M.Ed.
2017 SOA Annual Meeting & Exhibit

PEGGY HAUSER, FSA, MAAA
JOHN HEBIG, FSA, MAAA
NICOLE PITTMAN, M.ED., JD, CLTC, ACS, ALMI

Session 183, What’s New With LTC? A Regulatory and Product Development Update on the LTC Industry
October 18, 2017
Active participation in the Society of Actuaries is an important aspect of membership. While the positive contributions of professional societies and associations are well-recognized and encouraged, association activities are vulnerable to close antitrust scrutiny. By their very nature, associations bring together industry competitors and other market participants.

The United States antitrust laws aim to protect consumers by preserving the free economy and prohibiting anti-competitive business practices; they promote competition. There are both state and federal antitrust laws, although state antitrust laws closely follow federal law. The Sherman Act, is the primary U.S. antitrust law pertaining to association activities. The Sherman Act prohibits every contract, combination or conspiracy that places an unreasonable restraint on trade. There are, however, some activities that are illegal under all circumstances, such as price fixing, market allocation and collusive bidding.

There is no safe harbor under the antitrust law for professional association activities. Therefore, association meeting participants should refrain from discussing any activity that could potentially be construed as having an anti-competitive effect. Discussions relating to product or service pricing, market allocations, membership restrictions, product standardization or other conditions on trade could arguably be perceived as a restraint on trade and may expose the SOA and its members to antitrust enforcement procedures.

While participating in all SOA in person meetings, webinars, teleconferences or side discussions, you should avoid discussing competitively sensitive information with competitors and follow these guidelines:

- **Do not** discuss prices for services or products or anything else that might affect prices
- **Do not** discuss what you or other entities plan to do in a particular geographic or product markets or with particular customers.
- **Do not** speak on behalf of the SOA or any of its committees unless specifically authorized to do so.
- **Do** leave a meeting where any anticompetitive pricing or market allocation discussion occurs.
- **Do** alert SOA staff and/or legal counsel to any concerning discussions
- **Do** consult with legal counsel before raising any matter or making a statement that may involve competitively sensitive information.

Adherence to these guidelines involves not only avoidance of antitrust violations, but avoidance of behavior which might be so construed. These guidelines only provide an overview of prohibited activities. SOA legal counsel reviews meeting agenda and materials as deemed appropriate and any discussion that departs from the formal agenda should be scrutinized carefully. Antitrust compliance is everyone’s responsibility; however, please seek legal counsel if you have any questions or concerns.
Presentation Disclaimer

Presentations are intended for educational purposes only and do not replace independent professional judgment. Statements of fact and opinions expressed are those of the participants individually and, unless expressly stated to the contrary, are not the opinion or position of the Society of Actuaries, its cosponsors or its committees. The Society of Actuaries does not endorse or approve, and assumes no responsibility for, the content, accuracy or completeness of the information presented. Attendees should note that the sessions are audio-recorded and may be published in various media, including print, audio and video formats without further notice.
Valuation Update
Valuation Agenda

• **What is happening? Why does it matter for LTC?**
• **GAAP**
  • Targeted improvements
  • IFRS 17
• **Statutory**
  • NAIC AAT revisions – Actuarial Guideline LTC
  • Principles Based Reserves
GAAP

Targeted Improvements
**FASB targeted improvements – long duration contracts**

**Proposed improvements:**

- Annual (or more frequent) updating of cash flow assumptions for liability for future policy benefits using retrospective method
- Quarterly update of discount rate assumptions through OCI
- Upper medium grade fixed income instrument yield (proxy liability rate) vs. “expected investment yield” used today
- Simplified DAC amortization:
  - Based on insurance in-force, or straight-line
  - No interest accretion and no impairment test
- Detailed disaggregated rollforwards of liabilities and DAC; qualitative and quantitative information about estimates
- Prospective transition for liabilities and DAC

---

**Responding to user requests to update assumptions, simplify, and improve consistency**

**FASB proposed ED “targeted improvements” are pervasive**
**FASB targeted improvements – long duration contracts:**
Updating of cash flow assumptions

<table>
<thead>
<tr>
<th>FASB tentative decision</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Annually (same time each year) or more frequently if actual experience or other evidence indicates need for revision</td>
</tr>
<tr>
<td>• Retrospective unlocking:</td>
</tr>
<tr>
<td>• Revised net premium ratio as of contract inception would be computed using actual historical experience and updated cash flow assumptions</td>
</tr>
<tr>
<td>• At-inception discount rate used for interest accretion expense and the revised net premium ratio</td>
</tr>
<tr>
<td>• No provision for adverse deviation</td>
</tr>
<tr>
<td>• Net premium ratio capped at 100%, replacing the premium deficiency test</td>
</tr>
<tr>
<td>• Liability cannot be less than zero</td>
</tr>
<tr>
<td>• Maintenance expenses are period costs</td>
</tr>
</tbody>
</table>
What is the unit of account for the retrospective approach? Is it a “cohort”?

Should the same unit of account also be used for the 100% benefit ratio cap (which excludes DAC)?

Does quarterly discount rate update mandate quarterly cohorts?

Should the upper medium grade rate at contract issue date be required for long duration unpaid claim liabilities (as proposed)?

Should policy maintenance expenses be excluded from benefit liability (as proposed)?
IFRS 17: Background - Why is the IASB undertaking project on insurance contracts?

- Variety of accounting treatments depending on type of contract and which company issues it
- Estimates for long duration contracts not updated
- Discount rates do not reflect economic risks
- Lack of discounting for some contracts
- Little information on options and guarantees

IFRS 4 is an interim standard

Existing policies make comparison across products, companies and jurisdictions difficult

No transparent information for users
IFRS 17 – overview

**IFRS 17 will fundamentally change the measurement and reporting of insurers’ insurance contracts and it will involve significant change to organizations’ business models.**

**Who does it affect?**
- IFRS 17 applies to insurance contracts issued, to all reinsurance contracts, and to investment contracts with discretionary participating features if an entity also issues insurance contracts.

**When does it take effect?**
- The standard applies to annual periods beginning on or after January 1, 2021.
- Comparative balance sheets will need to be prepared for both December 31, 2021 and 2020.
- Earlier application is permitted if IFRS 15, ‘Revenue from Contracts with Customers’, and IFRS 9, ‘Financial Instruments’, are also applied.

**What will be required?**
- IFRS 17 requires a retrospectively implementation on transition to all in-force contracts.
- Simplification options exist where insufficient data are available to apply a full retrospectively methodology (i.e. modified/simplified retrospective approach and/or fair value approach).
IFRS 17 – overview

IFRS 17 is the proposed new international accounting standard for insurance contracts which replaces the existing IFRS 4 standard. The new standard provides a single global accounting standard for insurance contracts.

What is changing?

Balance Sheet

- IFRS 17 requires a current measurement model, where estimates are re-measured in each reporting period.
- The measurement is based on the building blocks of discounted, probability-weighted cash flows, a risk adjustment, and a contractual service margin (‘CSM’) representing the unearned profit of the contract.

Income Statement

- Requirements in IFRS 17 align the presentation of revenue with other industries. Investment components are excluded from revenue.
- Under IFRS 17, entities have an accounting policy choice to recognize the impact of changes in discount rates in profit or loss or in other comprehensive income (‘OCI’) to reduce some volatility in profit or loss.

Disclosures

- IFRS 17 disclosures will be more detailed than required under current reporting frameworks.
- Disclosures will provide additional insight into key judgements and profit emergence.
- Disclosures are designed to allow greater comparability across entities.
**Liability measurement models**

IFRS 17 adopts a general model for the measurement of insurance contracts, the building block approach. For certain types of contracts a modified methodology (i.e., variable fee approach) or simplified methodology (i.e., the premium allocation approach) can be adopted.

<table>
<thead>
<tr>
<th>Why is it needed?</th>
<th>Key features</th>
<th>Types of contract</th>
</tr>
</thead>
</table>
| **BBA**           | To be used as the default model for all insurance contracts | • Long-term and whole life insurance, protection business  
 |                   | • Discounted cash flow model with allowance for risk.  
 |                   | • Market-consistent valuation of options and guarantees.  
 |                   | • Discount rates reflect characteristics of the insurance contracts.  
 |                   | • No day one profits – recognised as a contractual service margin (CSM) and amortised in profit and loss (P&L) over contract term.  
 |                   | • New income statement presentation and definition of revenue.  
 |                   | • Other comprehensive income (OCI) option for changes in discount rates to reduce P&L volatility.  
 |                   | • Transition approach allows significant simplifications.  | • Life contingent annuities  
 |                   | • Discount rates reflect characteristics of the insurance contracts.  | • Universal Life  
 |                   | • No day one profits – recognised as a contractual service margin (CSM) and amortised in profit and loss (P&L) over contract term.  | • Reinsurance contracts  
 |                   | • New income statement presentation and definition of revenue.  | • Certain general insurance contracts  
 |                   | • Other comprehensive income (OCI) option for changes in discount rates to reduce P&L volatility.  | |
| **PAA**           | To simplify for short term contracts with little variability | • Short term general insurance  
 |                   | • Optional simplified model is allowed for short duration contracts.  
 |                   | • Applied to measure the pre-claims liability – akin to unearned premium accounting.  
 |                   | • The BBA is applied to determine the liability for incurred claims.  | • Short term group contracts  
 |                   | | • Short term reinsurance contracts  
| **Variable fee approach** | To deal with participating business where the liability is tied to underlying items | • Unit-linked contracts  
 |                   | • Reflects the link to underlying returns for contracts that participate in a clearly identified pool of underlying items.  
 |                   | • As per BBA with additional features, notably.  
 |                   | • Changes in insurers’ share of assets recognised in CSM.  
 |                   | • Accretion of interest on CSM at current rates.  
 |                   | • Profit or loss movement in liabilities mirrors treatment on underlying assets.  | • Certain participating contracts  
 |                   | | • Variable annuities and equity index-linked contracts  

1. Premium Allocation Approach – See our publication: [General insurers should not ignore IFRS 17](#)  
2. Other Comprehensive Income (OCI) comprises items of income and expenditure that are not recognised in P&L
**Building Block Approach (BBA)**

**Overview**

- Default model for all insurance contracts.
- Based on discounted best estimate of future cash flows (in and out).
- Explicit margins:
  - Contractual service margin to prevent gain on policy inception.
  - Risk adjustment.
- Day 1 loss recognised in income statement.
- Cash flow approach for all liabilities: past claims (including IBNR) and future cover.

**Diagram**

- **Contractual service margin**
- **Risk adjustment**
- **Discounting**
- **Best estimate of fulfilment cash flows**

---

Unearned profits recognised over coverage period.

Reflect compensation entity requires for uncertainty. Quantifies the value difference between certain and uncertain liability.

Discounting future cash flows using ‘top-down’ or ‘bottom-up’ approach for discount rates to reflect characteristics of the liabilities.

Best estimate cash flows – explicit, unbiased and probability weighted estimate of fulfilment cash flows.
Building Block Approach (BBA)

Expected changes in underwriting and net investment earnings patterns:

• BBA requires recognition for explicit profit margin based on transfer of services vs. implicit margin under various methods of current US GAAP.
• Lower premium revenue due to exclusion of more deposit elements (investment components).
• Impact of changes in assumptions are offset against contractual service margin and recognized prospectively.
• Liability rather than asset rate used to discount and impact of changes in the rate recorded in OCI.
• All guarantees and options are required to be recorded, including all interest rate guarantees.
Statutory Valuation Changes

NAIC AAT Changes – Actuarial Guideline LTC
Actuarial Guideline LTC

Adopted by LTCAWG in May, by HATF and the Health Insurance and Managed Care Committee in June and at the summer national meeting by the Executive Committee and Plenary. The relevant requirements include:

1. Scope - companies with 10,000 lives insured for LTC. Combo products excluded.

2. Effective - 12/31/17

3. Requires standalone testing of LTC reserves.
Actuarial Guideline LTC

4. If testing uses CFT for both the LTC business and for all significant blocks of non-LTC business, then results may be aggregated with other business. Otherwise, standalone AAT reserves are required for LTC to cover any deficiencies.

5. Limitation on assumption of future increases, must be:
   • Based upon a rate increase plan that is documented
   • Supported by and has been approved by management
   • Is highly likely to be undertaken, and
   • Contains rate increase requests and timelines by jurisdiction.
   • Assumptions should reflect a reasonable estimate of regulatory approved amounts and implementation timelines.
Actuarial Guideline LTC

6. Documentation requirements for AOM specified.

- Results
- Assumptions including specific rates and adjustments
- Summary of experience or other support/rationale for assumptions
- Rate increases
  - Separately identify already approved versus future
    - Approved - By jurisdiction with approved implementation timelines
    - Future – By policy form or policy grouping; describe development
  - Evidence that rate increase assumptions appropriately reflect management’s plan
- Assumptions that have significantly changed from the prior year’s analysis
Statutory Valuation Changes

Principles Based Reserves
Principles based reserves

Purpose:
• Replace the current formulaic approach to determining policy reserves with an approach that more closely reflects the risk of highly complex products
• “Right-size” reserves
• More dynamic reserve requirements to meet the needs of today’s products
• Reserves will be based more on own company experience

Implementation:
• Effective date = 1/1/2017 for 47 states
• Life insurance new issues
• Ability to phase in over three year period
Principles based reserves:

Impact on LTC

- No stochastic modeling requirement for LTC currently scheduled.
- Work of PBR LTC committee produced preliminary modeling:
  - Modeled process risk associated with morbidity and persistency
  - Did not integrate parameter risk, interest rate risk or potential management rate actions
  - Very complex
- LTC Valuation (B) Subgroup will review AG-LTC filings for year-end 2017 and determine if anything beyond AG-LTC is needed to create a PBR framework for LTCI reserves
- Section 9 of VM-20 is related to setting mortality assumptions for life insurance
  - The period of time used for the experience study should be at least three exposure years and should not exceed ten exposure years
  - LTC carriers tend to err on side of more credibility versus more reliability
LTC Rate Increase Environment and Regulatory Update
Milliman Long-Term Care Rate Increase Survey
An Industry Survey of Strategies and Experiences with Rate Increases
Milliman Long-Term Care Rate Increase Survey

• Prepared by Milliman in 2016
• Future reports
• The full report, and also a summary article, are available online
Survey – Participants

• 26 companies participated
• 73% of industry by premium volume
Survey – Rate Increase Determination

• Annual experience analysis
• Requests vary by jurisdiction
• Drivers of rate increases
Survey – Common Department Objections

• Reducing requested amounts
  • Recouping past losses
  • Low historical loss ratios
  • Non-actuarial reasons

• Phased-in increases

• Policyholder Notification Letter Revisions

• Rate guarantees
Survey – Approval Process

• Rate increase regulations and review processes vary greatly by state
• Approvals typically occur under 6 months
Survey – Approval Summary

• 75% of rate increase requests received full or partial rate increases
• Approvals, or disapprovals, are not always determined on an actuarial basis
Survey – Approval Summary

![Graph showing the average rate increase approved vs. generic rate increase requested, with a 100% approval line for reference.]

- Average Rate Increase Approved
- Generic Rate Increase Requested
- 100% Approval Line for Reference
Long-Term Care Rate Increase Hearings
Rate Hearings – Maryland

• Hearings held on a quarterly basis
• Required to attend when requesting a rate increase
• Common questions:
  • What were the assumptions used?
  • What is being included in the notification letters sent to policyholders
  • What would the rate increase requests be without the 15% cap?
  • Are landing spots being offered with the rate increase?
Rate Hearings – Massachusetts

• Informational hearings held November of 2016
• Q and A website regarding the early 2017 rate increases
• The largest approved rate increases were 40% and affected 55,000 policyholders in the state
Rate Hearings – Pennsylvania

• Hearing held March of 2016

• Common questions:
  • Is the rate increase designed to subsidize other lines of business?
  • How are options communicated to policyholders?
  • Why the delay in filing rate increases?
  • Are landing spots available?
Rate Hearings – Summary

• Consumer feedback
• Transparency of future rate increase intentions
• Limiting financial burden
NAIC Long-Term Care Developments
NAIC – Rate Increase Reviews

• Recouping “past losses” and comparison of review methods
  • Recast loss ratio method
  • Health Actuarial Task Force discussions
  • Texas
  • Minnesota
NAIC – Phased-In Rate Increases

• Should rate increases be approved in their entirety or in stages?
  • Insurer solvency concern
  • Policyholder financial impact
  • Informed decision
Rate Increase Regulation Updates
Regulation Updates – Florida
Updated approach rather than regulation

• Carriers to request rate increases which they will be able to live with
  • Typically phased-in with a 10 year lock out period
  • Willing to approve larger rate increases with this stipulation
Regulation Updates – California
Updated approach rather than regulation

• Long list of “Automatic Questions”
• Unreasonable Assumptions
Regulation Updates – Maryland

Senate Bill 176

• Moratorium on LTC rate increases
• Had a committee hearing which ended without any further movement
Regulation Updates – New Hampshire

NHCAR Ins 3601.19 Premium Rate Schedule Increases

- 60/80 test
- New business rate caps
- Maximum allowable rate increases based on attained age
New Product Development Update
Combination

Asset-Based

Hybrid

Linked Benefit
Combination products made-up 74% of the $3.8B in total LTC sales.
101 products (almost) on the market
<table>
<thead>
<tr>
<th>Life</th>
<th>Regulations</th>
<th>Health</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>FEDERAL VIEW</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>IRC 101(g)</td>
<td></td>
<td>IRC 7702B</td>
</tr>
<tr>
<td>IRC 101 (treated as death benefit)</td>
<td></td>
<td>IRC 104 (treated as amounts received for personal injuries and sickness)</td>
</tr>
<tr>
<td><strong>STATE VIEW</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Model Reg. 620 Accelerated Death Benefit</td>
<td></td>
<td>Model Reg. 640 Long-Term Care Insurance</td>
</tr>
</tbody>
</table>
Stand-alone qualified long-term care insurance contract

“This contract is intended to be a qualified long-term care insurance contract under IRC 7702B”
Life Insurance Policy with an incidental life benefit

(Policy Types: UL, IUL, VUL, GUL, OR WL)
Long-term care coverage can be provided through a rider on a life insurance contract

7702B(e) Treatment of coverage provided as part of a life insurance or annuity contract

Except as otherwise provided in regulations prescribed by the Secretary, in the case of any long-term care insurance coverage (whether or not qualified) provided by a rider on or as part of a life insurance contract or an annuity contract—

7702B(e)(1) This title shall apply as if the portion of the contract providing such coverage is a separate contract.

The LTC rider is deemed a separate contract.
Expanded how LTC coverage could be brought to market ...
Life insurance **with a qualified long-term care insurance contract, in the form of an LTCI rider**

“This contract is intended to be a qualified long-term care insurance contract under IRC 7702B”
Life insurance *with TWO* qualified long-term care insurance contracts, in the form of LTCI riders.

Often referred to as Hybrid Products.
Annuity *with* a qualified long-term care insurance contract, in the form of an LTCI rider
Chronic Illness Riders and Long-Term Care Riders are often times confused with each other

**Significant Differences:**
- Receive different federal tax treatment
- Must comply with different state regulations
- Have different policy administration requirements for carriers
- Require different marketing/sales practices to minimize confusion
- Require different consumer protection product features
Even Newer Products . . .

- Life Insurance Policy
- Short-Term Care Rider
- Life Insurance-type Benefits
- Life Insurance-type Benefits
- Term Insurance Policy
- LTC Rider
- Stand-Alone LTC policy
- Even Newer Products . . .
Other variations/innovations ...

- Tax deductibility of premium
- How coverage is paid for:
  - Modal premium at issue
  - Monthly rider charge at issue
  - Discount at time of claim
  - Policy Lien at time of claim

- Where care can be provided
- Who can provide care
- Length of benefit period
- Length of elimination period
- Payment types:
  - Reimbursement,
  - Professional indemnity,
  - Cash indemnity, or
  - A combination of types

• Modal premium at issue
• Monthly rider charge at issue
• Discount at time of claim
• Policy Lien at time of claim