

# **Texas Response to Adoption of the Minnesota Method as the Single Method of Rate Review and of Adoption of the Revised Cost Sharing Techniques.**

## **Cost Sharing Methods**

- **Current Method**

Given the MN Method as applied, we believe the current cost sharing may be optimal. However, if assumptions are “tightened”, the Current Method may become too restrictive.

- **Recently Adopted**

This method justifies larger rate increases with restrictions once the cumulative rate increase exceeds 400%.

**Texas prefers the Current Method since we believe The Recently Adopted method is too restrictive. If a new method is adopted, we would support the cost sharing proposal from the revised methodology.**

## **Texas is opposed to adoption of the Minnesota Method**

Texas’ primary concern with the current MN Method is that it may justify excessive rate increases. There are three reasons for this:

- Use of the statutory discount interest rate for projections
- Use of a 60% pricing loss ratio
- When applicable, not considering the 58/85 test rate stabilization requirement (Model Regulation 641) that was adopted by most states. While uncommon, Texas has seen a few filings where the proposed increase fails the 58/85 dual loss ratio test, but is justified under alternative approaches, including the TX PPV method.

## **Discount Rate**

Any lifetime approach method is highly sensitive to the discount rate, including the MN Method. The standard valuation rate (which is used to determine minimal contract reserves) will immediately justify a significant rate increase.

**Why is an adjustment to the discount rate necessary?** If the average yield and the pricing yield is 5.5%, for example, and the standard valuation rate is 4.0%, the model will project non-existent historical losses. As a possible solution, Texas recommends use of Moody’s Monthly Average Corporate Yields found on the NAIC website.

For historical projections, the minimum of the geometric average or the pricing yield is appropriate (to measure impact of historically low yields). For future projections, the pricing yield seems appropriate but could be modified if excessive.

### **Target Loss Ratio**

The justified rate increase is also highly sensitive to the target loss ratio. The target loss ratio should reflect rate stability for consistency with the NAIC LTC Model Regulation (MDL – 641). This requirement is also consistent with the LTC Multistate Rate Review Framework.

This adjustment is similar to that used for the TX PPV Method except the Cumulative Rate Increase (C) includes the approved rate increase for the current rate adjustment filing. This is necessary because of the future projection of experience.

$$\text{Target Loss Ratio} = \frac{.58 + .85 * C}{1 + C}$$

**Why is an adjustment to the loss ratio necessary?** Use of the initial pricing loss ratio (60%) permits recoupment of non-existent expense losses. The initial pricing loss ratio includes initial commissions and other acquisition costs. These expenses reflect premiums at issue and should be omitted for future rate increases.

### **Texas Modification to the Minnesota Method**

Texas has explored a hybrid review method that calls for a modification of the MN Method primarily with the considerations above in our internal analysis of rate filings (“TX Modified-MN Method”). Under this hybrid review method, we have found that the TX PPV Method routinely justifies a rate increase between the TX Modified-MN Method without cost sharing, and the TX Modified-MN Method with cost sharing.

The TX PPV Method has no cost sharing (although it requires the company to assume interest rate risk) and for some older blocks, the TX PPV Method may support rate increases that exceed the TX Modified-MN Method without cost sharing. We therefore appreciate and support any suggestions for cost sharing to restrict rate increases to older blocks in late durations where there is limited access to future premiums that would address any deficiencies.

While Texas does not rely on the TX Modified-MN Method for our approved rate increases, we now routinely evaluate and compare the results of the two methods. We attempt to reconcile any large discrepancies during our normal review process.

## **Balance between Company Solvency and Fairness to Policyholders**

Texas strives to strike a balance between rates that support company solvency and that is fair to consumers.

While mindful of the importance of a premium rate that supports claims obligations, we are required by Texas law (Texas Insurance Code Section 560.002 (c)(3)(B)) to ensure that rates represent a “reasonable relationship to the expected loss.” This statute is consistent with Actuarial Standards of Practice (ASOP) 8 - Section 3.11.3.

These are the types of questions we consider with respect to Section 560.002 and ASOP 8:

- Large rate increases to older, declining blocks commonly have an insignificant impact on the lifetime loss ratio. We increasingly see company strategies to implement extremely large increases, hopeful that policyholders will either significantly reduce benefits or lapse coverage and qualify for nonforfeiture. We question whether such a strategy is fair to the average consumer in these blocks – typically aged in the eighties or even nineties – who often have limited to no alternative market options.
- With rate increase that may exceed 500%, consumers (and regulators) are justified to ask: “Where is the transfer of risk?”
- Since LTC premiums are issue-age based, the rate charged to a person who purchased a policy at age 55, and who is now 85, should bear a reasonable relationship to rates charged to someone who is 55.

## **Additional Observations**

### **Transparency**

Texas conducts independent thorough analysis of LTC rate increase filings to ensure these rates are justified before approval. Our analysis must be transparent in accordance with ASOP 41, Section 3.2. This is also required of the multistate actuarial review (MSA) according to the Framework Checklist (Item 13 found on page 20).

In short, we must be able to actuarially support any rate increase that we approve. Likewise, Texas is transparent with our analysis subject to proprietary and confidentiality concerns with respect to our independent analysis and conclusions.

### **Waiver of Premium**

This is more of a theoretical concern. In our internal analysis, we are uncertain if historical experience includes policies on waiver of premium as losses, and it may be a reasonable assumption that waived premium losses do not significantly impact the results.

Since currently, we do not use our analysis to justify rate increase, Texas generally does not insist that the company excludes policies on waiver of premium from the historical experience.

Why does this matter? The use of waived premium losses cannot be rectified by rate increases. For example, a 100% rate increase on a \$100 monthly premium would only double the losses.

### **Contract Reserve Oversight**

LTC products are like annuity products in that contract reserves are representative of assets backing the product. Contract reserves are crucially important to ensure sustainability for LTC contracts.

Still, if a lifetime approach produces consistent results, states can address contract reserve adequacy as they deem appropriate.

### **Maximum Permissible Rate Increase**

Even before the application of cost sharing, the MN Method imposes a limitation on future rate increases based on the ratio of remaining policyholders to total policyholders. We modified this ratio to reflect available present value of future premium compared to total premium not as a matter of preference, but because we do not require tracking of historical policyholders by year.

### **Texas PPV Method Compared to the TX Modified-MN Method**

The actuarial team in Texas appreciate the additional perspective that the MN Method provides. This approach compliments weaknesses of relying on a singular approach such as the TX PPV Method. The TX PPV Method can also be modified to address weaknesses such as the low interest rate environment and cost sharing. But if a singular approach is preferred, modifications can be made to reasonably address the weaknesses.

Some points to consider:

- The TX Method and the MN Method are different approaches to address the same concern – adequacy of rates.
- As such, both methods should produce similar results.
- Large differences in the calculated rate increase suggest issues with one or both methods.

While our recent reviews (currently over 30 filings) do not rely on the TX Modified-MN Method, as noted previously, we are consistently finding that the Texas PPV Method recommended rate increase falls between the TX Modified-MN Method rate increase without cost sharing, and the TX Modified-MN Method with cost sharing.

### **When the TX PPV approach exceeds TX Modified-MN Method without cost sharing**

We have seen this happen with some filings. These blocks were characterized by a low number of remaining policyholders, and consequently limited access to future premiums. In cases such as these, we prefer the TX Modified-MN Method.

**When the TX PPV approach is lower than the TX Modified-MN Method with cost sharing**

This result indicates a loosening of assumptions in future projections resulting in lower claim reserves used in the gross premium analysis as well as asset adequacy testing such as used in AG-51. Still in these cases, the TX Modified – MN Method recommendation would be acceptable in most cases.