From: R Michael Markham <R.Michael.Markham@tdi.texas.gov>
Sent: Friday, July 14, 2023 1:18 PM
To: Andersen, Frederick (COMM) <frederick.andersen@state.mn.us>; Lombardo, Paul <Paul.Lombardo@ct.gov>; Tomasz Serbinowski (tserbinowski@utah.gov) <tserbinowski@utah.gov>
Cc: Eric King (EKing@naic.org) <eking@naic.org>
Subject: RE: LTC Working Group Comments

Can I have my comments from the June 7th email below included in the discussion related to a combined approach for LTC rate review discussion?

Also comments that I sent to the MSA Team in the May 4th email may also be relevant; particularly shortcomings in the MN and TX Approaches, copied below:

TX PPV Formulas

Description

The TX PPV formulas compare differences in the Contract Reserves between the old and new assumptions, holding contract reserves fixed at the point of valuation and distributing any deficit over the remaining available future premium. The method ensures the block is profitable using 58/85 for rate stabilized block and 60/80 pre-rate stabilized prospectively assuming contract reserves were held at a responsible level using the prior assumptions. Interest rates are set at the conservative Statutory Valuation Rate which supports larger rate increases and requires insurers to bear the interest rate risk. By bearing the interest rate risk, insurers are permitted to gain additional profits when yields exceed the statutory valuation rate which is almost always the case, but may suffer loss if the yields fall below the statutory valuation rate or if the company assumed a higher yield in pricing.

The PPV formulas ignores the impact of the historical lapse, though in both cases this is favorable to insurers:
- If lapses are higher, the company can retain the additional profits
- If lapses are lower than assumed, the increase in projected benefits is passed to the consumers via the increase in required contract reserves.

The TX Method by focusing on contract reserve deficiency and taking a prospective approach filters historic losses.

Issues with this Method

- Impact of shock lapses, non-forfeiture lapse, and benefit buydowns from the prior rate increase is not considered in the formulas
- Policyholders are required to bear the full brunt of any contract reserve deficiency without any cost sharing from the company
- In the later durations, the formulas will justify excessive rate increases
- Using the Statutory Valuation Rate permits the company to sustain additional profits when yields exceed the statutory valuation rate.
- The formulas do not give relief to insurers when the yields fall below the statutory valuation rate or assumed pricing yield.

One additional note, approving a rate increase in excess of that permitted by the PPV formulas permit insurers to realize an immediate profit by releasing contract reserves.

MN Approach

Description

The MN Approach is different from the TX Approach in that this method looks at the Lifetime Loss Ratio. The method determines an "IF-Knew" rate increase based on original target loss ratio, and calculates an additional "Make Up" increase to permit insurers to share the costs of prior losses and contract reserve deficiencies with policyholders, though requiring insurers to bear some of the loss. Deficiencies are spread across remaining available premium. By looking on historical performance, this method does adjust for favorable historical experience including shock lapses, benefit buydowns, and non-forfeiture lapses. The MN Method also assumes the Statutory Valuation Rate.

Issues with this Method

- By not adjusting the gross premium to net premium when reviewing historical experience, companies are permitted recoup non-existent historical expense losses* in both the "IF – Knew" and "Make-up" tables
- Companies are permitted to recoup historical losses
- Using this Statutory Valuation Rate historically permits companies to aggregate the losses when the yield falls between the pricing and the statutory yield
- Using the Statutory Valuation Rate historically and prospectively, the company would be permitted a rate increase at issue reflecting the difference between the pricing and statutory yield
- In the later durations, the formulas will justify excessive rate increases
- When the MN Method "justifies" a rate increase above the TX Method, companies

are permitted an immediate profit by the release of contract reserves.

* - Historical administrative expenses such as acquisition costs and commissions are based on the premium and do not need to be recouped.

Finally, I want to address a legitimate concern regarding the TX Method in Utah's Comments.

A criticism of the TX method, especially when applied to legacy blocks with prior rate increases, was that it may result in counterintuitive results, and reliance on Original Pricing Assumptions.

- Contract Reserves are required to be calculated based on original pricing assumptions by Health Insurance Reserves Model Regulation (MDL-10)- Section 4 with the following exceptions.

    a. One-Year Preliminary Term,

    b. Mandated low statutory interest rate, and

    c. Lapse restriction on the decrement calculation.

These assumptions should not change over the lifetime of the contracts. This includes morbidity, changes in underlying assumptions are addressed in the annual adequacy test (i.e. Gross Premium Valuation)

- Adequacy of Contract Reserves are required to be reviewed annually also by Health Insurance Reserves Model Regulation (MDL-10)- Section 4 – D using current assumptions.

The Texas PPV Formulas by definition pass any deficiency in contract reserves to the policyholders over the available future premium, with the exception that insurers are required to bear the interest rate risk.

- If the full rate increase as authorized by the prior assumptions are not given, "counterintuitive" results may result.

These factors must be taken into account, when reviewing subsequent rate increases.

Some concluding comments on LTC in general

- The sustainability of LTC blocks is dependent on the level and sustainability of contract reserves
- The Texas PPV Formulas takes a prospective approach focusing directly on contract reserve adequacy at the time of valuation.

The Texas method assumes current rates reflect the most recent assumptions which may not be the case
- The MN Approach takes a lifetime loss ratio approach but is highly dependent on the assumed discount rate.
- The MN Approach does not consider the current level of contract reserves.

An underlying issue regarding LTC, is the unsustainability of LTC policies with inflation protection.

Texas would prefer a LTC product that is sustainable over the lifetime of the contract with proper oversight and management of contract reserves including rate increases as needed to contain the premiums particularly in the later durations.

Thanks,

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Cc: Eric King (EKing@naic.org) <eking@naic.org>
Subject: LTC Working Group Comments

Good Afternoon,

Some comments related to developing a combined approach for LTC rate review.

The TX PPV Approach takes a prospective view of rate and contract reserves adequacy and would benefit from taking a lifetime view of the block of business that the MN Approach presents.

I would like to present some topics that would be obstacles to TX approving a combined approach

Contract Reserve Adequacy – The sustainability of Long Term Care blocks is dependent on having sufficient contract reserves. The TX approach focuses on contract reserves and the strengthening of contract reserves. The TX PPV formulas basically set a cap on rate increases based on contract reserve levels using prior assumptions. When the TX PPV formulas produce a negative value and when rate increases exceed the TX PPV "justified" rate increase, the company would experience an immediate profit from the rate increase.

Skewness when Low Interest Rates are assumed – The MN method by assuming a discount rate below market yields "justify" excessive rate increases. The MN method is also volatile based on yields assumed prospectively. Setting historical yields equal to a standard such as the Moody's Corp Avg Yield would remove this distortion historically. The prospective yield is more tricky, but setting this yield equal to the company's pricing yield would be consistent.

I am reluctant to considering interest rates, because I fear that it will generally work against the industry. Though consideration due to the historical low yields may be temporarily appropriate.

Distortion from Waiver of Premium – The TX Approach only considers active premium paying lives which removes the waiver of premium distortion. For disabled lives, companies using the "Total Claims" approach consider non-existent premium offset by "lost" premium resulting in an additional 100% loss ratio claim.

The disabled life reserve set up at the time of incident can contain a component for recovery addressing the contract which must be set up upon recovery.

The MN Approach appears to depart from the 58/85 requirement of Rate Stabilization – This is inconsistent with requirements of the LTC Model Regulation (MDR 641). For states that have adopted rate stabilization, this would make the rate increase out of compliance. It would also make MSA recommended rate increases out of compliance with recommended NAIC regulations.

Inflation Protection – Automatic inflation protection policies which is required in compliance LTC Model Regulation is a major contributor to the large rate increases we are seeing with LTC blocks. Inflation protection can result in exponential growth of expected liabilities (claims) while available premium is shrinking as the block ages. This is perhaps the greatest challenge we face in order to stabilizing the costs of LTC contracts. One potential solution is to permit an optional annual adjustment to premium based on the age at the time of inflation adjusted benefit (I can elaborate in another email).

Addressing Inflation Protection would also require revisions in the LTC Model Regulation. Texas also has inflation protection consistent with MDR 641 in our code.

The Guiding Principles presented by ACLI appear consistent with TX objectives. Texas has no objection to accepting these principles.

Finally there are practical considerations when utilizing the TX PPV formulas such as reliance on initial and prior assumptions as well as the cumulative rate increases. Though initial assumptions are required by Health Insurance Reserves Model Regulation (MDL-10) (and Texas Code) in order to determine statutory contract reserves, many companies simply do not have them. There are also legitimate industry concerns when prior rate increases are below TX PPV formula recommendations. It is a reality that we face when reviewing rates particularly for older blocks. TX addresses these issues as they arise on a case-by-case basis.

Out of respect for time, I don't want to press these issues, but am available to discuss as needed.

Thanks,

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