February 23, 2023

Paul Lombardo, Co-Chair
Fred Andersen, Co-Chair
Long-Term Care Actuarial (B) Working Group
National Association of Insurance Commissioners (NAIC)

Re: Accounting Interpretation Request: Interaction Between *Actuarial Guideline LI* (AG 51) and Appendix A-010

Dear Mr. Lombardo and Mr. Andersen,

On behalf of the Financial Reporting and Solvency Committee ("the committee") of the Health Practice Council of the American Academy of Actuaries,[1] we are reaching out to you to ascertain whether the Long-Term Care Actuarial (B) Working Group might issue an accounting interpretation for the interaction between *Actuarial Guideline LI* (AG 51) and Appendix A-010.

In 2017, the National Association of Insurance Commissioners (NAIC) adopted AG 51, "The Application of Asset Adequacy Testing to Long-Term Care Insurance Reserves." Subsequent to the adoption of AG 51, the committee has observed some diversity in practice across issuers of long-term care insurance with regard to how the new guidance in AG 51, and specifically Section 4.C thereof, interacts with existing guidance on accident & health insurance reserve adequacy, as found in paragraph 24 of the Statement of Statutory Accounting Principles (SSAP) No. 54R, "Individual and Group Accident and Health Contracts," and paragraph 26 of Appendix A-010, "Minimum Reserve Standards for Individual and Group Accident and Health Insurance Contracts."

To our knowledge, the Long-Term Care Actuarial (B) Working Group has not previously been made aware that a diversity of practice has developed, subsequent to the adoption of AG 51, regarding how AG 51 interacts with Appendix A-010.

It would be helpful for Long-Term Care Actuarial (B) Working Group to review the attached Form A, and issue an interpretation to clarify the intended interaction between AG 51 and Appendix A-010, along the lines of one of the suggested interpretation statement wording options contained in the form. Note that we are not advocating for one of these options over the other; instead, our interest is in having the NAIC provide greater clarity to actuaries to understand its underlying intent.

[1] The American Academy of Actuaries is a 19,500-member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

1850 M Street NW Suite 300 Washington, DC 20036 Telephone 202 223 8196 Facsimile 202 872 1948 www.actuary.org

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We appreciate the opportunity to reach out to you on an accounting interpretation request for the interaction between *Actuarial Guideline LI* and Appendix A-010. We would welcome the opportunity to speak with you to provide more detail regarding these comments or on other issues. If you have any questions or would like to discuss further, please contact Matthew Williams, the American Academy of Actuaries senior health policy analyst, at williams@actuary.org.

Sincerely,

David Hutchins, MAAA, FSA
Chairperson, Financial Reporting and Solvency Committee
American Academy of Actuaries

CC: Dale Bruggeman, Chair, Statutory Accounting Principles (E) Working Group (SAPWG), Accounting Practices and Procedures (E) Task Force; Fred Andersen, Chair, Valuation Analysis (E) Working Group, Financial Condition (E) Committee. NAIC Support Staff: Eric King/Julie Gann/Patricia Allison

Attachment: Statutory Accounting Principles (E) Working Group Maintenance Agenda Submission Form—Form A

Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A

Issue:

Interaction Between Actuarial Guideline 51 and Appendix A-010

Check (applicable entity):

	P/C	Life	Health
Modification of existing SSAP	☐	☐	☐
New Issue or SSAP	☐	☐	☐
Interpretation	☐	☐	☒

Description of Issue:

In 2017, the National Association of Insurance Commissioners (NAIC) adopted Actuarial Guideline 51, "The Application of Asset Adequacy Testing to Long-Term Care Insurance Reserves" (hereafter, "AG 51"). Subsequent to the adoption of AG 51, we have observed some diversity in practice across issuers of long-term care insurance with regard to how the new guidance in AG 51, and specifically Section 4.C thereof, interacts with existing guidance on accident & health (A&H) insurance reserve adequacy, as found in paragraph 24 of Statement of Statutory Accounting Principles (SSAP) No. 54R, "Individual and Group Accident and Health Contracts," and paragraph 26 of Appendix A-010, "Minimum Reserve Standards for Individual and Group Accident and Health Insurance Contracts."

As an illustration of the observed diversity in practice, consider the following illustrative, simplified example:

1. Company XYZ has three lines of business: long-term care insurance, Medicare Supplement (Med Sup) insurance, and whole life insurance.

2. Cash flow testing performed for the long-term care block in isolation, in accordance with AG 51, shows deficiencies in all tested scenarios.

3. Cash flow testing performed for the entity as a whole, including both the life and A&H business combined, shows significant sufficiencies at the entity level in all tested scenarios.

4. A gross premium valuation performed on the long-term care reserves, in isolation, indicates that those reserves are deficient by $250 million.

5. A gross premium valuation performed on the Medicare Supplement reserves, in isolation, indicates that those reserves contain $150 million of sufficiency.

Given these facts, does Company XYZ need to strengthen its accident and health reserves in order to comply with the requirements of the NAIC Accounting Practices & Procedures Manual?

Depending on how one views the intended interaction between AG 51 and Appendix A-010, in this illustrative example one could conclude either that Company XYZ's reserves are adequate, or that they are deficient by $100 million.

Argument that the reserves are adequate:

- Section 4.C of AG 51 sets out conditions for "determining whether additional reserves are necessary" for a block of long-term care insurance.

- In particular, Section 4.C.1 of AG 51 says that "a reserve deficiency in the LTC block may be aggregated with sufficiencies in the company's other blocks of business for the purposes of developing an actuarial opinion, if cash-flow testing is used for both the LTC business and for all significant blocks of non-LTC business within a company."

- In light of point 3 above, this implies that Company XYZ does not need to establish any additional reserves for its long-term care block. In effect, here Company XYZ gets to use sufficiencies that exist in its life reserves to avoid needing to strengthen its LTC reserves.

- There had been an exposure draft of AG 51 in February 2017 that contained the following language: "Requirements for standalone analysis for a health insurance major block of contracts, per *Model Regulation #010*, still apply even if aggregation of cash-flow testing results occurs." However, this language was deleted from the version of AG 51 that was adopted later in 2017.

Argument that the reserves are deficient by $100 million:

- Combining points 4 and 5 above, a gross premium valuation performed on Company XYZ's A&H business in total shows a net deficiency of $100 million ($250 million LTC deficiency, offset by $150 million Med Supp sufficiency).

- Paragraph 26 of Appendix A-010 reads, in part, "…a gross premium valuation is to be performed whenever a significant doubt exists as to reserve adequacy with respect to any major block of contracts, or with respect to the insurer's health business as a whole. In the event inadequacy is found to exist, immediate loss recognition shall be made and the reserves restored to adequacy."

- Nothing in AG 51 explicitly amends the requirement from Appendix A-010 that an entity's A&H reserves, in total, need to be adequate; nor is AG 51 explicitly referenced within the Valuation Manual Section VM-25, "Health Insurance Reserves Minimum Reserve Requirements," as a source of guidance on minimum reserve requirements.

- Thus, Company XYZ's health reserves, taken as a whole, must at a minimum exceed the reserves produced by a gross premium valuation, regardless of AG 51. This would imply that Company XYZ needs to strengthen its LTC reserves by $100 million, bringing the total deficiency in the gross premium valuation of its A&H reserves to zero.

Existing Authoritative Literature:

Excerpts from SSAP No. 54R:

11. "… A prospective gross premium valuation is the ultimate test of reserve adequacy as of a given valuation date. …"

12. "The reserving methodologies and assumptions used in calculating individual and group accident and health reserves shall meet the provisions of Appendices A-010, A-641, A-820, A-822 (as applicable), the *Valuation Manual* and the actuarial guidelines found in Appendix C of this manual (as applicable). …"

24. "As discussed in Appendix A-010, a prospective gross premium valuation is the ultimate test of the adequacy of a reporting entity's accident and health reserves as of a given valuation date and shall

be determined on the basis of unearned premium reserves, contract reserves, additional reserves, claim reserves (including claim liabilities), and miscellaneous reserves combined, however, each component shall be computed separately."

Excerpts from Appendix A-010:

23. "These standards apply to all individual and group health and accident and sickness insurance coverages, including single premium credit disability insurance. All other credit insurance is not subject to Appendix A-010."

24. "When an insurer determines that adequacy of its health insurance reserves requires reserves in excess of the minimum standards specified herein, such increased reserves shall be held and shall be considered the minimum reserves for that insurer."

25. "With respect to any block of contracts, or with respect to an insurer's health business as a whole, a prospective gross premium valuation is the ultimate test of reserve adequacy as of a given valuation date. Such a gross premium valuation will take into account, for contract in force, in a claims status, or in a continuation of benefits status on the valuation date, the present value as of the valuation date of all expected benefits unpaid, all expected expenses unpaid, and all unearned or expected premiums, adjusted for future premium increases reasonably expected to be put into effect."

26. "Such a gross premium valuation is to be performed whenever a significant doubt exists as to reserve adequacy with respect to any major block of contracts, or with respect to the insurer's health business as a whole. In the event inadequacy is found to exist, immediate loss recognition shall be made and the reserves restored to adequacy. Adequate reserves (inclusive of claim, premium and contract reserves, if any) shall be held with respect to all contracts, regardless of whether contract reserves are required for such contracts under these standards."

Excerpts from NAIC Valuation Manual, Section VM-25:

A.1 "Reserve requirements for individual A&H insurance policies issued on and after the Valuation Manual operative date and reserve requirements for group A&H insurance certificates issued on and after the Valuation Manual operative date are applicable requirements found in the AP&P Manual; Appendix A, which includes A-10; and applicable requirements found in the AP&P Manual Appendix C, which includes … AG 28 … AG 44 … AG 47 … and … AG 50."

Excerpts from Actuarial Guideline 51:

"Background. The *Health Insurance Reserves Model Regulation (#010)* and the *NAIC Valuation Manual (VM-25)* contain requirements for the calculation of long-term care insurance (LTC) reserves. Regulators have observed a lack of uniform practice in the implementation of tests of reserve adequacy and reasonableness of LTC reserves. The reserve adequacy testing required by Model #10 and VM-25 does not provide regulators comfort as to the reserve adequacy of companies with material blocks of LTC business. As such, regulators must rely upon asset adequacy analysis required by the *NAIC Valuation Manual (VM-30)* to evaluate the solvency position of companies with sizeable blocks of LTC business. This Guideline is intended to provide uniform guidance and clarification of requirements for the appropriate support of certain assumptions for the asset adequacy testing applied to a company's block of LTC contracts. …"

4.B "Asset adequacy analysis specific to all inforce LTC business, and without consideration of results for other block of business within the company, must be performed for valuations associated with the December 31, 2017, and subsequent annual statutory financial statements. The analysis shall comply with applicable Actuarial Standards of Practice, including standards regarding identification of key risks. Material assumptions associated with the LTC business shall be determined using moderately adverse deviations in actuarial assumptions."

4.C "When determining whether additional reserves are necessary:

1. A reserve deficiency in the LTC block may be aggregated with sufficiencies in the company's other blocks of business for the purposes of developing an actuarial opinion, if cash-flow testing is used for both the LTC business and for all significant blocks of non-LTC business within a company. If a reserve deficiency in the LTC block is not offset with sufficiencies in the company's other blocks of business, then additional reserves shall be established as required by section 2.C.2. of *VM-30*."

2. "If cash-flow testing is not used for testing of the LTC business, then a reserve deficiency revealed from another method, e.g., a gross premium valuation, utilized for purposes of asset adequacy analysis of the LTC block under this Guideline shall not be offset with sufficiencies in the company's other blocks of business. The additional reserves under this Guideline shall be established based only upon the adequacy of the reserves in the LTC block."

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups):

Actuarial Guideline 51 was adopted by the Health Insurance and Managed Care (B) Committee in June 2017 and subsequently incorporated into Appendix C of the NAIC Accounting Practices & Procedures Manual.

As noted above, the February 2017 exposure draft of what was then called Actuarial Guideline LTC contained different language than the version adopted later that year as AG 51. The following are excerpts from the February 2017 exposure draft of AG LTC, with emphasis added. The bolded italicized language below does not exist, either verbatim or in modified form, within the adopted version of AG 51:

"Background The *Health Insurance Reserves Model Regulation (#010)* and the *NAIC Valuation Manual (VM-25)* contain requirements for the calculation of long-term care insurance (LTC) reserves. Regulators have observed a lack of uniform practice in the implementation of tests of reserve adequacy and reasonableness of LTC reserves. ***For instance, the Model Regulation states, "a gross premium valuation is to be performed whenever a significant doubt exists as to reserve adequacy with respect to any major block of contracts"; however, other wording in the Model Regulation creates confusion for some on whether the test of adequacy is required at the major block of contract level. In the absence of uniform guidance, insurers may not be determining adequacy of LTC reserves in a uniform manner.*** As such, this Guideline provides uniform guidance and limits to certain assumptions for the asset adequacy testing applied to an insurer's major LTC block of contracts. …"

3.C "When determining whether additional reserves are necessary:

1. In the case where cash-flow testing is used for both LTC business and for the companywide analysis.
    a. A deficiency in the LTC segment may be offset by a projected and justified overall cash-flow testing sufficiency in non-LTC segments. The LTC-related assumptions in the companywide cash-flow testing shall be the same as with the standalone LTC cash-flow testing.
    b. To the extent projected LTC reserve sufficiency is not offset through aggregation, reserves for LTC business shall be increased by any additional reserves required to eliminate the projected reserve insufficiency.

c. ***Requirements for standalone analysis for a health insurance major block of contracts, per Model Regulation #010, still apply even if aggregation of cash-flow testing results occurs."***

2. "In cases where cash-flow testing is not used for LTC business, reserves for LTC business shall be increased by any additional reserves required by the standalone LTC business asset adequacy analysis to eliminate a reserve insufficiency."

Information or issues (included in *Description of Issue*) not previously contemplated by the Working Group:

To our knowledge the Working Group has not previously been made aware that a diversity of practice has developed, subsequent to the adoption of AG 51, regarding how AG 51 interacts with Appendix A-010.

In May 2022, the actuarial consulting firm Milliman released its seventh triennial survey on long-term care valuation practices.[1] Figure 2 of that report presents information about the approach companies use for aggregating statutory reserve adequacy testing results. The three options shown were "LTC line of business," selected by 8 out of the 20 respondents; "health or life business lines combined," selected by 2 out of the 20; and "company level," selected by 10 out of the 20. Figure 1 of that report presents information about the types of reserve adequacy testing that is performed. The three options shown were "GPV only" ("Gross Premium Valuation only") selected by 3 out of the 20 respondents; "cash flow testing and GPV," selected by 4 out of the 20; and "cash flow testing only," selected by 13 out of the 20. Taking these two pieces of data together, it would appear that many of the 20 companies participating in this Milliman survey believe that performing cash flow testing at the legal entity level is enough to satisfy reserve adequacy considerations in light of AG 51, and that there is not a separate requirement for the legal entity's accident and health reserves to be adequate in aggregate under a gross premium valuation.

Recommended Conclusion or Future Action on Issue:

The committee recommends that the Working Group issue an interpretation to clarify the intended interaction between AG 51 and Appendix A-010, along the lines of one of the following two statements below, depending on which statement reflects the NAIC's underlying intent:

Statement A: "With respect to an entity having a block of LTC insurance subject to Actuarial Guideline 51, even if Section 4.C of Actuarial Guideline 51 implies that the entity does not need to establish additional reserves for the LTC block, it nevertheless remains true that the entity's accident & health reserves in total must be adequate under a gross premium valuation in accordance with paragraph 26 of Appendix A-010."

Statement B: "With respect to an entity having a block of LTC insurance subject to Actuarial Guideline 51, if Section 4.C of Actuarial Guideline 51 implies that the entity does not need to establish additional reserves for the LTC block, then the reserves for the LTC block are deemed to be adequate for purposes of applying the requirements of paragraph 26 of Appendix A-010 if no other A&H blocks are deficient."

[1] https://us.milliman.com/-/media/milliman/pdfs/2022-articles/5-24-22_2021_report_on_survey_of_ltci_valuation.ashx

Recommending Party:

American Academy of Actuaries, Health Practice Council
(Organization)

David Hutchins, MAAA, FSA, Chairperson, Financial Reporting and Solvency Committee
(Person Submitting, Title)

1850 M Street NW Suite 300 Washington, DC 20036
(Address, City, State, ZIP)

Matthew Williams, Senior Policy Analyst, Health
202-223-8196; williams@actuary.org
(Phone and Email Address)

February 23, 2023
(Date Submitted)

+Staff Recommendation:

+Staff Review Completed by:

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* Indicates required information before NAIC staff will accept form as a final document.
+ Indicates sections NAIC staff will complete upon receipt from recommending party.