

Actuarial & Finance



LDTI and Regulatory Updates on LTC Standalone and Hybrid Products

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Overview

- This session will cover both LDTI accounting changes and regulatory updates related to Hybrid products.
- We will use the first half of the session to go over the latest regulatory updates related to Hybrid products valuation and pricing.
- During the second half of the session, we will discuss how LDTI accounting changes impact LTC and Hybrid products, and considerations during implementation.

Regulatory Updates Related to Hybrid Products

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Regulatory Updates Related to Hybrid Products

- Principle-Based Reserves
- NY Regulation 213
- Internal Revenue Code §7702 Changes
- Life Nonforfeiture Changes
- California Assembly Bill 1209

Regulatory Updates Related to Hybrid Products

- Principle-Based Reserving (PBR)
- Became effective January 1, 2020
- Prior to PBR, static formulas and assumptions were used to determine life reserves as prescribed by state laws and regulations.
- Under PBR, insurers will be required to hold the higher of:
 - a) reserves using prescribed factors or
 - b) reserves which consider a wide range of future economic conditions and is computed using credible insurer experience factors specific to an insurer, such as mortality, policyholder behavior (e.g., lapses) and expenses.
- Acceleration riders may need to be included in PBR
- Life Valuation Interest Rate decreased from 3.5% to 3.0% for 2021
 - 4.5% to 3.75% for the ULSG component of the net premium reserve

Regulatory Updates Related to Hybrid Products

- NAIC/Academy Economic Scenario Generator for PBR
 - Being updated as early as 2022 to provide more adverse low interest rate scenarios
- NAIC considering future mortality improvement for PBR
 - Unlikely in NY

Regulatory Updates Related to Hybrid Products

- NY Regulation 213
- A more conservative version of NAIC PBR
- Adds a PBR floor equal to 100% of the pre-PBR ULSG requirements (assuming the 2017 CSO), including deficiency reserves
- Excess reserves over NAIC are not tax deductible
- NY reserve requirements apply extraterritorially unless using a NY-only company.

Regulatory Updates Related to Hybrid Products

- §7702 Changes
- On December 27, 2020, the Consolidated Appropriations Act, 2021, was signed into law. This included a change to the 7702-interest rate for policies issued on January 1, 2021 and later.
- Prior to this change, the interest rate used to calculate the MEC premium limits and the CVAT death benefit corridor was the greater of 4% or the rate guaranteed in the contract.
- For 2021, that interest rate is the greater of 2% and the rate guaranteed in the contract. In the future, the §7702 interest rate will adjust using the same timing of updates to nonforfeiture interest rates
- If the lower 2% rate can be used, then this results in:
 - Higher MEC premium limits
 - Lower CVAT death benefit corridor
- The GPT death benefit corridor did not change. However, the GPT premium limits are also subject to the lower interest rate. (2% for GLP and 4% for GSP in 2021)

Regulatory Updates Related to Hybrid Products

- Life Nonforfeiture Changes
- For policies issued on or after January 1, 2022, the nonforfeiture interest rate will decrease from 4.50% to 3.75%.
- This will impact the maximum surrender charges allowed.
 - Higher at younger ages
 - Lower at older ages
- This will also increase any tabular guaranteed cash value on whole life or fixed-premium universal life products.
- This change will generally require refiling of policy data pages, actuarial memos, and possibly policy forms.

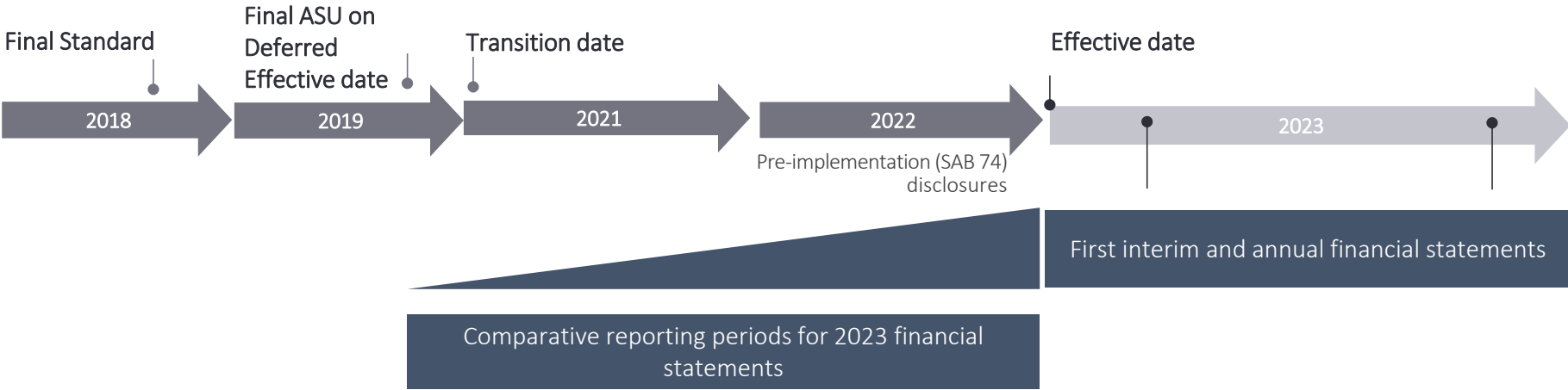
Regulatory Updates Related to Hybrid Products

- California AB 1209 enacted on October 8, 2019 (Adds §10235.45)
- Require disclosure of impact of acceleration payments on loans, withdrawals, etc. and vice versa.
- At least 30 days before the first payment of an accelerated death benefit for LTC goes out, an insurer is required to send the policyholder:
 - An explanation of any changes to the policy that would occur as a result of the LTC payment, including a prohibition or limitation of access to loans or cash withdrawals.
 - A numerical demonstration of the effect of the payment on the remaining death benefit, cash value, policy loan value, outstanding policy loan amount, no-lapse guarantee, policy lien, and premium payments or cost of insurance charges.
- If a policyholder initiates a request to take a loan or withdrawal from the cash value of a life insurance policy that accelerates benefits for LTC, the insurer shall provide the policyholder with explanation of any changes to the policy that would occur as a result of the loan or withdrawal.

Long Duration Targeted Improvements (LDTI) - A recap of the changes

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Timeline



- This is the proposed effective date for SEC filers.

Targeted Improvement

Targeted Improvement Areas	Products impacted
Liability for future policyholder benefits	Non-par traditional long-duration and limited payment contracts
Deferred acquisition costs (DAC)	All products except certain investment contracts
Disclosures	All long duration products
Market risk benefits	Deposit products with certain benefit features (e.g., VAs, FIAs)

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What is not changing

Existing ASC 944 guidance expected to be retained

- Classification of product types
- Measurement of liabilities carried at account balance
- Deferred acquisition costs
 - Identification and capitalization of costs that meet certain criteria
 - Classification of internal replacements (SOP 05-1)
 - Amortization of DAC for certain investment contracts
- Recognition of revenue
- Business combinations accounted for under ASC 944
- Areas indirectly impacted
 - Reinsurance accounting
 - Income tax accounting

Comparison to Current GAAP

Liability for future policyholder benefits (FPBR)

	Current GAAP	Targeted Improvements**
Cash flows	<ul style="list-style-type: none">• Assumptions and expected experience are locked into the net premium model at issuance• Assumptions include provision for adverse deviation (PAD)	<ul style="list-style-type: none">• Update cash flow assumptions and actual experience on cumulative catch-up basis (i.e., retrospective) in the net premium model• Remove PADs
Discount Rate	<ul style="list-style-type: none">• Discount rates locked into the model• Rate based on the expected investment yield	<ul style="list-style-type: none">• Update discount rate assumptions (i.e., single A rate) in current period• Rate based on the upper medium grade fixed income instrument yield (i.e., A rate)
Loss Recognition	<ul style="list-style-type: none">• Loss recognition testing	<ul style="list-style-type: none">• Loss recognition testing is eliminated

Comparison to Current GAAP

Deferred Acquisition Costs

	Current GAAP	Targeted Improvements
Assumptions and experience adjustments	<ul style="list-style-type: none">• Assumptions are locked in at issuance	<ul style="list-style-type: none">• Assumptions are reviewed at least annually and updated accordingly• Experience adjustments for unexpected contract terminations
Amortization Approach	<ul style="list-style-type: none">• Premium is often the amortization basis	<ul style="list-style-type: none">• Amortization on a constant level basis over the expected term of the contract• Grouped contracts must be the same as FPBR
Interest accretion	<ul style="list-style-type: none">• With interest accretion	<ul style="list-style-type: none">• Interest accretion is eliminated

Disclosures

General disclosure requirements for all insurance liabilities and DAC	Additional disclosures for certain insurance liabilities
<ul style="list-style-type: none"> Disaggregated rollforwards Qualitative and quantitative information Reconciliation to the carrying amount and certain income statement activity Techniques to determine unobservable discount rates 	<p>Liability for future policyholder benefits and the additional liability for benefit features</p> <ul style="list-style-type: none"> Separate rollforwards for expected future net premiums and benefits Ending balance of expected future gross premiums, both discounted and undiscounted Actual cash flow experience compared to expectations Reinsurance recoverable <p>Liability for policyholder's account balances</p> <ul style="list-style-type: none"> Account balances by range of guaranteed minimum crediting rates Weighted average credited rate Guaranteed benefit amounts in excess of account balances Cash surrender value
Disaggregation principles	<ul style="list-style-type: none"> Allow users to understand the amount, timing, and uncertainty of future cash flows arising from the liabilities Aggregate or disaggregate disclosures so that useful information is not obscured by the inclusion of a large amount of insignificant detail or by the aggregation of items that have significantly different characteristics At a minimum, disclosures must be disaggregated by reportable segment Consider how information has been presented for other purposes.

Long Duration Targeted Improvements (LDTI) -Implementation Case Study

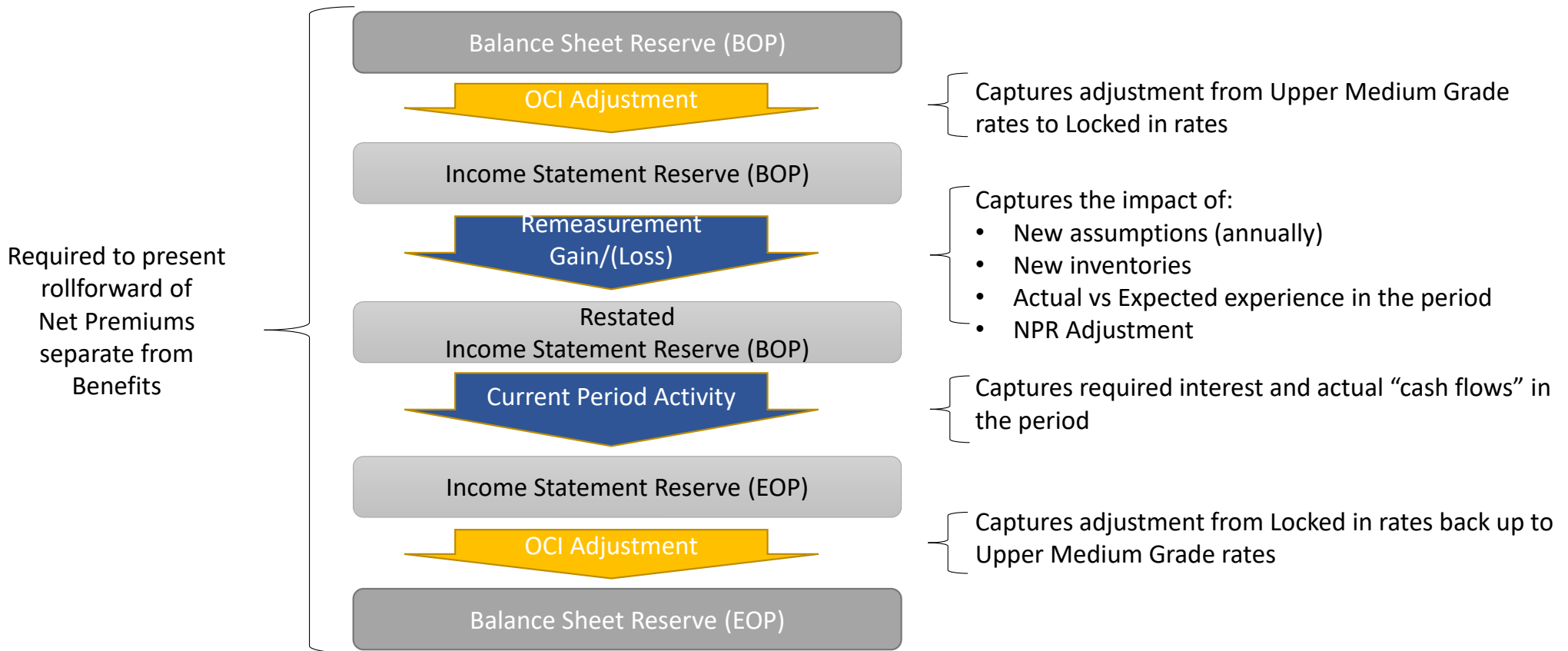
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Management Reporting

Reserve measurement at cohort level and at a total reserve basis complicates management reporting. ASC disclosure framework provides good starting point but likely insufficient for many internal reporting needs



Rollforwards



Rollforwards

		Benefits Presented Separately from Net Premiums	
		Benefits	- Net Premiums
(In millions)			
OCI Adj	a	Balance sheet reserve (BOP)	
	b	Adjustment to Locked in discount rate	+/-
	c	Income statement reserve (BOP)	
	d	Effect of actual vs expected experience on current period cash flows	+/-
	e	Effect of actual vs expected experience on future period cash flows	+/-
	f	Effect of actual vs expected experience	+/-
	g	NPR Adjustment (A to E Impact)	+/-
	h	Effect of changes in cash flow assumptions	+/-
	i	NPR Adjustment (Assumption Impact)	+/-
	j	Restated income statement reserve (BOP)	
	k	Required Interest	+
	l	Activity*	-Benefit Payments + Net Premiums
	m	Income statement reserve (EOP)	
	n	Adjustment to end of period discount rate	+/-
OCI Adj	o	Balance sheet reserve (EOP)	

*Also includes Issuances

Commentary

- Separate rollforwards are required for Benefits and Net Premiums
- The impact to the NPR ratio resulting from Actual vs Expected Experience and Changes in Cash Flow assumptions will all be captured in the Net Premium rollforward
 - ASU & Accounting Firm examples have not shown a separate rollforward item for the NPR adjustment
- Expect that internally will need to break the “Effect of Actual vs Expected Experience” and “Effect of Changes in Cash Flow Assumptions” into more granular buckets:
 - Current period vs future period
 - Lapse, Recovery, Mortality, Incurred, etc
- Expect that internally will want to bifurcate Benefits between Claim Reserves and ALR

Considerations

- How to create an integrated process to create a holistic income statement view
- Measuring financial impact of business drivers is now more difficult to measure and explain
 - Cohorts further complicate
 - Income from business drivers very different depending on if cohort is in a loss position or not
- Claim reserves separate from ALR
- Does it make sense to measure the NPR impact for each driver individually?
 - Can the model do that?
 - How to review on a seriatim basis?
- Are there other new metrics to consider?
 - NPR trends
 - Changes to Interest Adjusted Loss Ratios
- How best to evaluate business results below the cohort level to make strategic decisions

Learnings

- Management reporting to be complex and evolve
- Assume that model enhancements will be needed
 - Detailed testing of base models uncovered multiple bugs that had to be resolved
 - Learn from prior model development and plan accordingly
- Spend time on the details now
 - E.g. Where does the impact of flooring reserves at zero show up?
 - Independently mapping how calculations should work model can be independently validated
- Engage key stakeholders and business owners sooner rather than later
 - Expand networks of stakeholders
 - Share across the industry

Appendix - Rollforwards

	Measurement Levers						
	Discount Rate	Measure Time	Inventories for Future CF	NPR	Assumption Set	CF Used for Current Period	CF Used for Future Periods
(In millions)							
Balance sheet reserve (BOP)	Single A	T0	BOP	BOP	Old	Projections	Projections
Adjustment to Locked in discount rate							
Income statement reserve (BOP)	Locked	T0	BOP	BOP	Old	Projections	Projections
Effect of actual vs expected experience on current period cash flows	Locked	T0	BOP	BOP	Old	Actuals	0
Effect of actual vs expected experience on future period cash flows	Locked	T0	EOP	BOP	Old	0	Projections
Effect of actual vs expected experience	Locked	T0	EOP	BOP	Old	Actuals	Projections
NPR Adjustment (A to E Impact)	Locked	T0	EOP	EOP (Old Assumptions)	Old	Actuals	Projections
Effect of changes in cash flow assumptions	Locked	T0	BOP	EOP (Old Assumptions)	New	Projections	Projections
NPR Adjustment (Assumption Impact)	Locked	T0	EOP	EOP (New Assumptions)	New	Actuals	Projections
Restated income statement reserve (BOP)	Locked	T0	EOP	EOP	New	Actuals	Projections
Required Interest	Add Required Interest to move from T0 measurement period to T1						
Activity	Add/Less Actual Activity in Period						
Income statement reserve (EOP)	Locked	T1	EOP	EOP	New	n/a	Projections
Adjustment to end of period discount rate							
Balance sheet reserve (EOP)	Single A	T1	EOP	EOP	New	n/a	Projections