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CERTIFICATION OF AUTHORIZED OFFICER
I Hereby Certify That The Attached Rules Were Adopted
In Compliance with Act 434 of 1967 As Amended

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RULE AND REGULATION 22
MINIMUM RESERVE STANDARDS FOR INDIVIDUAL AND GROUP
DISABILITY INSURANCE CONTRACTS

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Section 1. Authority

This Rule is issued pursuant to the Authority vested in the Commissioner by Ark. Code Ann. §§ 23-63-607, 23-61-108, 25-15-201 et seq. and other applicable provisions of Arkansas law.

Section 2. Applicability and Scope

These standards apply to all individual and group disability insurance coverages except credit insurance.

When an insurer determines that adequacy of its disability 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.

With respect to any block of contracts, or with respect to an insurer's disability 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 contracts 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.

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

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1 with respect to the insurer's disability business as a whole. In the event
2 inadequacy is found to exist, immediate loss recognition shall be made and the
3 reserves restored to adequacy. Adequate reserves (inclusive of claim, premium
4 and contract reserves, if any) shall be held with respect to all contracts,
5 regardless of whether contract reserves are required for such contracts under
6 these standards.

7
8 Whenever minimum reserves, as defined in these standards, exceed reserve
9 requirements as determined by a prospective gross premium valuation, such
10 minimum reserves remain the minimum requirement under these standards.

11
12 The following sections set forth minimum standards for these categories of
13 disability insurance reserves: Section 4. Claim Reserves; Section 5. Premium
14 Reserves; and Section 6. Contract Reserves.

15
16 Adequacy of an insurer's disability insurance reserves is to be determined on the
17 basis of all three categories combined. However, these standards emphasize
18 the importance of determining appropriate reserves for each of the three
19 categories separately.

20
21 These standards contain two appendices which are an integral part of the
22 standards, and one additional "supplementary" appendix which is not part of the
23 standards as such, but is included for explanatory and illustrative purposes only.
24 These are:

25
26 Appendix A. Specific minimum standards with respect to morbidity, mortality and
27 interest, which apply to claim reserves according to year of incurral and to
28 contract reserves according to year of issue;

29
30 Appendix B. Glossary of Technical Terms used; and

31
32 Appendix C. (Supplementary) Waiver of Premium Reserves.

33
34
35 Section 3. Effective Date

36
37 The provisions of this rule shall become effective on January 1, 1999, upon
38 statutory filing per Arkansas law.

39
40 Section 4. Claim Reserves

41
42 A. General

- 43
44 (1) Claim reserves are required for all incurred but unpaid claims on all
45 disability insurance policies.
46

- 1 (2) Appropriate claim expenses reserves are required with respect to
2 the estimated expense of settlement of all incurred but unpaid
3 claims.
4
5 (3) All such reserves for prior valuation years are to be tested for
6 adequacy and reasonableness along the lines of claim runoff
7 schedules in accordance with the statutory financial statement
8 including consideration of any residual unpaid liability.
9

10 B. Minimum Standards for Claim Reserves
11

12 (1) Disability Income
13

14 (a) Interest. The maximum interest rate for claim reserves is
15 specified in Appendix A.
16

17 (b) Morbidity. Minimum standards with respect to morbidity are
18 those specified in Appendix A, except that, at the option of
19 the insurer:
20

21 (i) For claims with a duration from date of disablement of
22 less than two (2) years, reserves may be based on
23 the insurer's experience, if such experience is
24 considered credible, or upon other assumptions
25 designed to place a sound valuation on the liabilities.
26

27 (ii) For group disability income claims with a duration
28 from date of disablement of more than two (2) years
29 but less than five (5) years, reserves may, with the
30 approval of the Commissioner, be based on the
31 insurer's experience for which the insurer maintains
32 underwriting and claim administration control. The
33 request for such approval of a plan of modification to
34 the reserve basis must include:
35

36 (I) An analysis of the credibility of the experience;
37

38 (II) A description of how all of the insurer's
39 experience is proposed to be used in setting
40 reserves;
41

42 (III) A description and quantification of the margins
43 to be included;
44

- (IV) A summary of the financial impact that the proposed plan of modification would have had on the insurer's last filed annual statement;
- (V) A copy of the approval of the proposed plan of modification by the Commissioner of the state of domicile; and
- (VI) Any other information deemed necessary by the Commissioner.

NOTE: For experience to be considered credible for purposes of Item (ii), the company should be able to provide claim termination patterns over no more than six (6) years reflecting at least five thousand (5,000) claims terminations during the third through fifth claims durations on reasonably similar applicable policy forms.

For claim reserves to reflect "sound values" and reasonable margins, reserve tables based on credible experience should be adjusted regularly to maintain reasonable margins. Demonstrations may be required by the Commissioner of the state of domicile based on published literature (e.g. Goldman, TSA XLII).

- (c) Duration of Disablement. For contracts with an elimination period, the duration of disablement should be measured as dating from the time that benefits would have begun to accrue had there been no elimination period.

(2) All Other Benefits.

- (a) Interest. The maximum interest rate for claim reserves is specified in Appendix A.
- (b) Morbidity or Other Contingency. The reserve should be based on the insurer's experience, if the experience is considered credible, or upon other assumptions designed to place a sound value on the liabilities.

C. Claim Reserves Methods Generally.

A generally accepted actuarial reserving method or other reasonable method, if, after a public hearing, the method is approved by the Commissioner prior to the statement date, or a combination of methods may be used to estimate all claim liabilities. The methods used for estimating liabilities generally may be aggregate methods, or various reserve items may be separately valued. Approximations based on groupings and averages may also be employed. Adequacy of the claim reserves, however, shall be determined in the aggregate.

Section 5. Premium Reserves

1
2 A. General

- 3
4 (1) Unearned premium reserves are required for all contracts with
5 respect to the period of coverage for which premiums, other than
6 premiums paid in advance, have been paid beyond the date of
7 valuation.
8
9 (2) If premiums due and unpaid are carried as an asset, the premiums
10 must be treated as premiums in force, subject to unearned
11 premium reserve determination. The value of unpaid commissions,
12 premium taxes and the cost of collection associated with due and
13 unpaid premiums shall be carried as an offsetting liability.
14
15 (3) The gross premiums paid in advance for a period of coverage
16 commencing after the next premium due date which follows the
17 date of valuation may be appropriately discounted to the valuation
18 date and shall be held either as a separate liability or as an addition
19 to the unearned premium reserve which would otherwise be
20 required as a minimum.
21

22 B. Minimum Standards for Unearned Premium

- 23
24 (1) The minimum unearned premium reserve with respect to a contract
25 is the pro rata unearned modal premium that applies to the
26 premium period beyond the valuation date, with the premium
27 determined on the basis of:
28
29 (a) The valuation net modal premium on the contract reserve
30 basis applying to the contract; or
31
32 (b) The gross modal premium for the contract if no contract
33 reserve applies.
34
35 (2) However, in no event may the sum of the unearned premium and
36 contract reserves for all contracts of the insurer subject to contract
37 reserve requirements be less than the gross modal unearned
38 premium reserve on all such contracts, as of the date of valuation.
39 The reserve shall never be less than the expected claims for the
40 period beyond the valuation date represented by the unearned
41 premium reserve, to the extent not provided for elsewhere.
42

43 C. Premium Reserve Methods Generally

44
45 The insurer may employ suitable approximations and estimates; including,
46 but not limited to groupings, averages and aggregate estimation; in

1 computing premium reserves. Approximations or estimates should be
2 tested periodically to determine their continuing adequacy and reliability.

3
4 Section 6. Contract Reserves

5
6 A. General

7
8 (1) Contract reserves are required, unless otherwise specified in
9 Section 6(A)(2) for:

10
11 (a) All individual and group contracts with which level premiums
12 are used; or

13
14 (b) All individual and group contracts with respect to which, due
15 to the gross premium pricing structure at issue, the value of
16 the future benefits at any time exceeds the value of any
17 appropriate future valuation net premiums at that time. The
18 values specified in this subparagraph shall be determined on
19 the basis specified in Subsection B of this section.

20
21 (2) Contracts not requiring a contract reserve are:

22
23 (a) Contracts that cannot be continued after one (1) year from
24 issue; or

25
26 (b) Contracts already in force on the effective date of these
27 standards for which no contract reserve was required under
28 the immediately preceding standards.

29
30 (3) The contract reserve is in addition to claim reserves and premium
31 reserves.

32
33 (4) The methods and procedures for contract reserves shall be
34 consistent with those for claim reserves for a contract, or else
35 appropriate adjustment shall be made when necessary to assure
36 provision for the aggregate liability. The definition of the date of
37 incurral shall be the same in both determinations.

38
39 B. Minimum Standards for Contract Reserves

40
41 (1) Basis

42
43 (a) Morbidity or Other Contingency. Minimum standards with
44 respect to morbidity are those set forth in Appendix A.
45 Valuation net premiums used under each contract shall have
46 a structure consistent with the gross premium structure at

1 issue of the contract as this relates to advancing age of
2 insured, contract duration and period for which gross
3 premiums have been calculated.
4

5 Contracts for which tabular morbidity standards are not
6 specified in Appendix A shall be valued using tables
7 established for reserve purposes by a qualified actuary and
8 acceptable to the Commissioner. The morbidity tables shall
9 contain a pattern of incurred claims cost that reflects the
10 underlying morbidity and shall not be constructed for the
11 primary purposes of minimizing reserves.
12

13 (b) Interest. The maximum interest rate is specified in Appendix
14 A.
15

16 (c) Termination Rates. Termination rates used in the
17 computation of reserves shall be on the basis of a mortality
18 table as specified in Appendix A except as noted in the
19 following items:
20

21 (i) Under contracts for which premium rates are not
22 guaranteed, and where the effects of insurer
23 underwriting are specifically used by policy duration in
24 the valuation morbidity standard or for return of
25 premium or other deferred cash benefits, total
26 termination rates may be used at ages and durations
27 where these exceed specified mortality table rates,
28 but not in excess of the lesser of:
29

30 (I) Eighty percent (80%) of the total termination
31 rate used in the calculation of the gross
32 premiums, or
33

34 (II) Eight percent (8%).
35

36 (ii) For long-term care individual policies or group
37 certificates issued after January 1, 1998, the contract
38 reserve may be established on a basis of separate:
39

40 (I) Mortality (as specified in Appendix A); and
41

42 (II) Terminations other than mortality, where the
43 terminations are not to exceed:
44

- 45 • For policy years one (1) through four (4),
46 the lesser of eighty percent (80%) of the

1 voluntary lapse rate used in the calculation
2 of gross premiums and eight percent (8%);
3

- 4 • For policy years five (5) and later, the lesser
5 of one hundred percent (100%) of the
6 voluntary lapse rate used in the calculation
7 of gross premiums and four percent (4%).
8

- 9 (iii) Where a morbidity standard specified in Appendix A is
10 on an aggregate basis, the morbidity standard may be
11 adjusted to reflect the effect of insurer underwriting by
12 policy duration. The adjustments must be appropriate
13 to the underwriting and be acceptable to the
14 Commissioner.
15

16 (2) Reserve Method.
17

- 18 (a) For insurance except long-term care and return of premium
19 or other deferred cash benefits, the minimum reserve is the
20 reserve calculated on the two-year full preliminary term
21 method; that is, under which the terminal reserve is zero at
22 the first and also the second contract anniversary.
23

- 24 (b) For long-term care insurance, the minimum reserve is the
25 reserve calculated as follows:
26

- 27 (i) For individual policies and group certificates issued on
28 or before December 31, 1998, reserves calculated on
29 the two-year full preliminary term method;
30

- 31 (ii) For individual policies and group certificates issued on
32 or after January 1, 1999, reserves calculated on the
33 two-year full preliminary term method.
34

- 35 (c) (i) For return of premium or other deferred cash benefits,
36 the minimum reserve is the reserve calculated as
37 follows:
38

- 39 (I) On the one year preliminary term method if the
40 benefits are provided at any time before the
41 twentieth anniversary;
42

- 43 (II) On the two year preliminary term method if the
44 benefits are only provided on or after the
45 twentieth anniversary.
46

(ii) The preliminary term method may be applied only in relation to the date of issue of a contract. Reserve adjustments introduced later, as a result of rate increases, revisions in assumptions (e.g., projected inflation rates) or for other reasons, are to be applied immediately as of the effective date of adoption of the adjusted basis.

(3) Negative Reserves. Negative reserves on any benefit may be offset against positive reserves for other benefits in the same contract, but the total contract reserve with respect to all benefits combined may not be less than zero.

(4) Nonforfeiture Benefits for Long-Term Care Insurance. The contract reserve on a policy basis shall not be less than the net single premium for the nonforfeiture benefits at the appropriate policy duration, where the net single premium is computed according to the above specifications.

C. Alternative Valuation Methods and Assumptions Generally

Provided the contract reserve on all contracts to which an alternative method or basis is applied is not less in the aggregate than the amount determined according to the applicable standards specified above; an insurer may use any reasonable assumptions as to interest rates, termination and mortality rates, and rates of morbidity or other contingency. Also, subject to the preceding condition, the insurer may employ methods other than the methods stated above in determining a sound value of its liabilities under such contracts, including, but not limited to the following: the net level premium method; the one-year full preliminary term method; prospective valuation on the basis of actual gross premiums with reasonable allowance for future expenses; the use of approximations such as those involving age groupings, groupings of several years of issue, average amounts of indemnity, groupings of similar contract forms; the computation of the reserve for one contract benefit as a percentage of, or by other relation to, the aggregate contract reserves exclusive of the benefit or benefits so valued; and the use of a composite annual claim cost for all or any combination of benefits included in the contracts valued.

D. Tests For Adequacy and Reasonableness of Contract Reserves

Annually, an appropriate review shall be made of the insurer's prospective contract liabilities on contracts valued by tabular reserves, to determine the continuing adequacy and reasonableness of the tabular reserves giving consideration to future gross premiums. The insurer shall make

1 appropriate increments to such tabular reserves if such tests indicate that
2 the basis of such reserves is no longer adequate; subject, however, to the
3 minimum standards of Section 6(B).
4

5 In the event a company has a contract or a group of related similar
6 contracts, for which future gross premiums will be restricted by contract,
7 insurance department regulations, or for other reasons, such that the
8 future gross premiums reduced by expenses for administration,
9 commissions, and taxes will be insufficient to cover future claims, the
10 company shall establish contract reserves for such shortfall in the
11 aggregate.
12

13 Section 7. Reinsurance
14

15 Increases to, or credits against reserves carried, arising because of reinsurance
16 assumed or reinsurance ceded, must be determined in a manner consistent with
17 these minimum reserve standards and with all applicable provisions of the
18 reinsurance contracts which affect the insurer's liabilities.
19

20 Section 8. Severability
21

22 Any section or provision of this Rule held by a court to be invalid or
23 unconstitutional will not affect the validity of any other section or provision of this
24 Rule.
25
26
27
28
29

30 

31 MIKE PICKENS
32 INSURANCE COMMISSIONER
33 STATE OF ARKANSAS
34

35 7/6/98
36

DATE

1 APPENDIX A. SPECIFIC STANDARDS FOR MORBIDITY, INTEREST
2 AND MORTALITY
3

4 I. MORBIDITY
5

6 A. Minimum morbidity standards for valuation of specified individual
7 contract disability insurance benefits are as follows:
8

9 (1) Disability Income Benefits Due to Accident or Sickness.
10

11 (a) Contract Reserves:
12

13 Contracts issued on or after January 1, 1965 and prior
14 to January 1, 1992:
15

16 The 1964 Commissioners Disability Table (64
17 CDT).
18

19 Contracts issued on or after January 1, 1999:
20

21 The 1985 Commissioners Individual Disability
22 Tables A (85CIDA); or
23

24 The 1985 Commissioners Individual Disability
25 Tables B (85CIDB).
26

27 Contracts issued during 1992-1998:
28

29 Optional use of either the 1964 Table or the
30 1985 Tables.
31

32 Each insurer shall elect, with respect to all individual
33 contracts issued in any one statement year, whether it
34 will use Tables A or Tables B as the minimum
35 standard. The insurer may, however, elect to use the
36 other tables with respect to any subsequent statement
37 year.
38

39 (b) Claim Reserves:
40

41 The minimum morbidity standard in effect for contract
42 reserves on currently issued contracts, as of the date
43 the claim is incurred.
44
45
46

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46
- (2) Hospital Benefits, Surgical Benefits and Maternity Benefits
(Scheduled benefits or fixed time period benefits only).

- (a) Contract Reserves:

Contracts issued on or after January 1, 1955, and
before January 1, 1982:

The 1956 Intercompany Hospital-Surgical
Tables.

Contracts issued on or after January 1, 1982:

The 1974 Medical Expense Tables, Table A,
Transactions of the Society of Actuaries,
Volume XXX, pg. 63. Refer to the paper (in the
same volume, pg. 9) to which this table is
appended, including its discussions, for
methods of adjustment for benefits not directly
valued in Table A: "Development of the 1974
Medical Expense Benefits," Houghton and
Wolf.

- (b) Claim Reserves:

No specific standard. See (5) below.

- (3) Cancer Expense Benefits (Scheduled benefits or fixed time
period benefits only).

- (a) Contract Reserves:

Contracts issued on or after January 1, 1986: The
1985 NAIC cancer Claim Cost Tables.

- (b) Claim Reserves:

No specific standard. See (5) below.

- (4) Accidental Death Benefits.

- (a) Contract Reserves:

Contracts issued on or after January 1, 1965: the
1959 Accidental Death Benefits Table.

1 (b) Claim Reserves:

2
3 Actual amount incurred.

4
5 (5) Other Individual Contract Benefits.

6
7 (a) Contract Reserves:

8
9 For all other individual contract benefits, morbidity
10 assumptions are to be determined as provided in the
11 reserve standards.

12
13 (b) Claim Reserves:

14
15 For all benefits other than disability, claim reserves
16 are to be determined as provided in the standards.
17

18 B. Minimum morbidity standards for valuation of specified group
19 contract disability insurance benefits are as follows:

20
21 (1) Disability Income Benefits Due to Accident or Sickness.

22
23 (a) Contract Reserves:

24
25 Contracts issued prior to January 1, 1997:

26 The same basis, if any, as that employed by
27 the insurer as of January 1, 1997.

28
29 Contracts issued on or after January 1, 1999:

30 The 1987 Commissioners Group Disability
31 Income Table (87CGDT).
32

33 Contracts issued during 1997-1998:

34 Optional use of either the 87CGDT or the prior
35 basis.
36

37 (b) Claim Reserves:

38
39 For claims incurred on or after January 1, 1999:

40 The 1987 Commissioners Group Disability
41 Income Table (87CGDT);
42

43 For claims incurred prior to January 1, 1999:

44 Use of the 87CGDT is optional.
45

46 (2) Other Group Contract Benefits.

1
2 (a) Contract Reserves:
3

4 For all other group contract benefits, morbidity
5 assumptions are to be determined as provided in the
6 reserve standards.
7

8 (b) Claims Reserves:
9

10 For all benefits other than disability income, claim
11 reserves are to be determined as provided in the
12 standards.
13

14 II. INTEREST
15

16 A. For contract reserves the maximum interest rate is the maximum
17 rate permitted by Arkansas law in the valuation of whole life
18 insurance issued on the same date as the disability insurance
19 contract.
20

21 B. For claim reserves on policies that require contract reserves, the
22 maximum interest rate is the maximum rate permitted by Arkansas
23 law in the valuation of whole life insurance issued on the same date
24 as the claim incurral date.
25

26 C. For claim reserves on policies not requiring contract reserves, the
27 maximum interest rate is the maximum rate permitted by Arkansas
28 law in the valuation of single premium immediate annuities issued
29 on the same date as the claim incurral date, reduced by one
30 hundred basis points.
31

32 III. Mortality
33

34 A. Unless Subsection B applies, the mortality basis used for all
35 policies except long-term care individual policies and group
36 certificates and for long-term care individual policies or group
37 certificates issued before January 1, 1999, shall be according to a
38 table (but without use of selection factors) permitted by law for the
39 valuation of whole life insurance issued on the same date as the
40 disability insurance contract. For long-term care insurance
41 individual policies or group certificates issued on or after January 1,
42 1999, the mortality basis used shall be the 1983 Group Annuity
43 Mortality Table without projection.
44

45 B. Other mortality tables adopted by the NAIC and promulgated by the
46 Commissioner may be used in the calculation of the minimum

1 reserves if appropriate for the type of benefits and if approved by
2 the Commissioner. The request for approval shall include the
3 proposed mortality table and the reason that the standard specified
4 in Subsection A is inappropriate.

APPENDIX B. GLOSSARY OF TECHNICAL TERMS USED

As used in this valuation standard, the following terms have the following meaning:

ANNUAL-CLAIM COST. The net annual cost per unit of benefit before the addition of expenses, including claim settlement expenses, and a margin for profit or contingencies. For example, the annual claim cost for a \$100 monthly disability benefit, for a maximum disability benefit period of one year, with an elimination period of one week, with respect to a male at age 35, in a certain occupation might be \$12, while the gross premium for this benefit might be \$18. The additional \$6 would cover expenses and profit or contingencies.

CLAIMS ACCRUED. That portion of claims incurred on or prior to the valuation date which result in liability of the insurer for the payment of benefits for medical services which have been rendered on or prior to the valuation date, and for the payment of benefits for days of hospitalization and days of disability which have occurred on or prior to the valuation date, which the insurer has not paid as of the valuation date, but for which it is liable, and will have to pay after the valuation date. This liability is sometimes referred to as a liability for "accrued" benefits. A claim reserve, which represents an estimate of this accrued claim liability, must be established.

CLAIMS REPORTED. When an insurer has been informed that a claim has been incurred, if the date reported is on or prior to the valuation date, the claim is considered as a reported claim for annual statement purposes.

CLAIMS UNACCRUED. That portion of claims incurred on or prior to the valuation date which result in liability of the insurer for the payment of benefits for medical services expected to be rendered after the valuation date, and for benefits expected to be payable for days of hospitalization and days of disability occurring after the valuation date. This liability is sometimes referred to as a liability for unaccrued benefits. A claim reserve, which represents an estimate of the unaccrued claim payments expected to be made (which may or may not be discounted with interest), must be established.

CLAIMS UNREPORTED. When an insurer has not been informed, on or before the valuation date, concerning a claim that has been incurred on or prior to the valuation date, the claim is considered as an unreported claim for annual statement purposes.

DATE OF DISABLEMENT. The earliest date the insured is considered as being disabled under the definition of disability in the contract, based on a doctor's evaluation or other evidence. Normally this date will coincide with the start of any elimination period.

1 *ELIMINATION PERIOD.* A specified number of days, weeks, or months starting
2 at the beginning of each period of loss, during which no benefits are payable.

3
4 *GROSS PREMIUM.* The amount of premium charged by the insurer. It includes
5 the net premium (based on claim-cost) for the risk, together with any loading for
6 expenses, profit or contingencies.

7
8 *GROUP INSURANCE.* The term group insurance includes blanket insurance
9 and franchise insurance and any other forms of group insurance.

10
11 *LEVEL PREMIUM.* A premium calculated to remain unchanged throughout
12 either the lifetime of the policy, or for some shorter projected period of years.
13 The premium need not be guaranteed, in which case, although it is calculated to
14 remain level, it may be changed if any of the assumptions on which it was based
15 are revised at a later time.

16
17 Generally, the annual claim costs are expected to increase each year and the
18 insurer, instead of charging premiums that correspondingly increase each year,
19 charges a premium calculated to remain level for a period of years or for the
20 lifetime of the contract. In this case the benefit portion of the premium is more
21 than needed to provide for the cost of benefits during the earlier years of the
22 policy and less than the actual cost in the later years. The building of a
23 prospective contract reserve is a natural result of level premiums.

24
25 *LONG-TERM CARE INSURANCE.* For the purposes of this Regulation, "long
26 term care insurance" shall have the meaning set forth in Section 4 of Act 642 of
27 1989, codified at Ark. Code Ann. §23-97-203.

28
29 *MODAL PREMIUM.* This refers to the premium paid on a contract based on a
30 premium term which could be annual, semi-annual, quarterly, monthly, or weekly.
31 Thus if the annual premium is \$100 and if, instead, monthly premiums of \$9 are
32 paid then the modal premium is \$9.

33
34 *NEGATIVE RESERVE.* Normally the terminal reserve is a positive value.
35 However, if the values of the benefits are decreasing with advancing age or
36 duration it could be a negative value, called a negative reserve.

37
38 *PRELIMINARY TERM RESERVE METHOD.* Under this method of valuation the
39 valuation net premium for each year falling within the preliminary term period is
40 exactly sufficient to cover the expected incurred claims of that year, so that the
41 terminal reserves will be zero at the end of the year. As of the end of the
42 preliminary term period, a new constant valuation net premium (or stream of
43 changing valuation premiums) becomes applicable such that the present value of
44 all such premiums is equal to the present value of all claims expected to be
45 incurred following the end of the preliminary term period.

1 *PRESENT VALUE OF AMOUNTS NOT YET DUE ON CLAIMS.* The reserve for
2 "claims unaccrued" (see definition), which may be discounted at interest.
3

4 *RESERVE.* The term "reserve" is used to include all items of benefit liability,
5 whether in the nature of incurred claim liability or in the nature of contract liability
6 relating to future periods of coverage, and whether the liability is accrued or
7 unaccrued.
8

9 An insurer under its contracts promises benefits which result in:
10

11 (a) Claims which have been incurred, that is, for which the insurer has
12 become obligated to make payment, on or prior to the valuation
13 date. On these claims, payments expected to be made after the
14 valuation date for accrued and unaccrued benefits are liabilities of
15 the insurer which should be provided for by establishing claim
16 reserves; or
17

18 (b) Claims which are expected to be incurred after the valuation date.
19 Any present liability of the insurer for these future claims should be
20 provided for by the establishment of contract reserves and
21 unearned premium reserves.
22

23 *TERMINAL RESERVE.* This is the reserve at the end of a contract year, and is
24 defined as the present value of benefits expected to be incurred after that
25 contract year minus the present value of future valuation net premiums.
26

27 *UNEARNED PREMIUM RESERVE.* This reserve values that portion of the
28 premium paid or due to the insurer which is applicable to the period of coverage
29 extending beyond the valuation date. Thus if an annual premium of \$120 was
30 paid on November 1, \$20 would be earned as of December 31 and the remaining
31 \$100 would be unearned. The unearned premium reserve could be on a gross
32 basis as in this example, or on a valuation net premium basis.
33

34 *VALUATION NET MODAL PREMIUM.* This is the modal fraction of the valuation
35 net annual premium that corresponds to the gross modal premium in effect on
36 any contract to which contract reserves apply. Thus if the mode of payment in
37 effect is quarterly, the valuation net modal premium is the quarterly equivalent of
38 the valuation net annual premium.

APPENDIX C. RESERVES FOR WAIVER OF PREMIUM

(Supplementary explanatory material)

Waiver of premium reserves involve several special considerations. First, the disability valuation tables promulgated by the NAIC are based on exposures that include contracts on premium waiver as in-force contracts. Hence, contract reserves based on these tables are NOT reserves on "active lives" but rather reserves on contracts "in force." This is true for the 1964 CDT and for both the "1985 CIDA and CIDB tables."

Accordingly, tabular reserves using any of these tables should value reserves on the following basis:

Claim reserves should include contracts on premiums expected to be waived, valuing as a minimum the valuation net premium being waived.

Premium reserves should include contracts on premium waiver as in-force contracts, valuing as a minimum the unearned modal valuation net premium being waived.

Contract reserves should include recognition of the waiver of premium benefit in addition to other contract benefits provided for, valuing as a minimum the valuation net premium to be waived.

If an insurer is, instead, valuing reserves on what is truly an active life table, or if a specific valuation table is not being used but the insurer's gross premiums are calculated on a basis that includes in the projected exposure only those contracts for which premiums are being paid, then it may not be necessary to provide specifically for waiver of premium reserves. Any insurer using such a true "active life" basis should carefully consider, however, whether or not additional liability should be recognized on account of premiums waived during periods of disability or during claim continuation.