

11 NCAC 11F .0205 CONTRACT RESERVES

(a) General:

- (1) Contract reserves are required, unless otherwise specified in this Rule for:
 - (A) All individual and group contracts with which level premiums are used; or
 - (B) All individual and group contracts with respect to which, due to the gross premium pricing structure at issue, the value of the future benefits at any time exceeds the value of any appropriate future valuation net premiums at that time. This evaluation may be applied on a rating block basis if the total premiums for the block were developed to support the total risk assumed and expected expenses for the block each year, and a qualified actuary certifies the premium development. The actuary shall state in the certification that premiums for the rating block were developed such that each year's premium was intended to cover that year's costs without any prefunding. If the premium is also intended to recover costs for any prior years, the actuary shall also disclose the reasons for and magnitude of such recovery. The values specified in this Subparagraph shall be determined on the basis specified in 11 NCAC 11F .0205(b).
- (2) Contracts not requiring a contract reserve are:
 - (A) Contracts that cannot be continued after one year from issue; or
 - (B) Contracts already in force on the effective date of these standards for which no contract reserve was required under the immediately preceding standards.
- (3) The contract reserve is in addition to claim reserves and premium reserves.
- (4) The methods and procedures for contract reserves shall be consistent with those for claim reserves for any contract, or else appropriate adjustment must be made when necessary to assure provision for the aggregate liability. The definition of the date of incurral must be the same in both determinations.

(b) Minimum Standards for Contract Reserves:

- (1) Basis:
 - (A) Minimum standards with respect to morbidity are those set forth in 11 NCAC 11F .0207. Valuation net premiums used under each contract must have a structure consistent with the gross premium structure at issue of the contract as this relates to advancing age of insured, contract duration and period for which gross premiums have been calculated. Contracts for which tabular morbidity standards are not specified in 11 NCAC 11F .0207 shall be valued using tables established for reserve purposes by a qualified actuary and acceptable to the Commissioner.
 - (B) The maximum interest rate is specified in 11 NCAC 11F .0207.
 - (C) Termination rates used in the computation of reserves shall be on the basis of a mortality table as specified in 11 NCAC 11F .0207 except as noted in Subparagraphs (b)(1)(C)(i) and (ii) of this Rule.
 - (i) Under contracts for which premium rates are not guaranteed, and where the effects of insurer underwriting are specifically used by contract duration in the valuation morbidity standard, or for return of premium or other deferred cash benefits, total termination rates may be used at ages and durations where these exceed specified mortality table rates, but not in excess of the lesser of:
 - (I) 80 percent of the total termination rate used in the calculation of the gross premiums; or
 - (II) Eight percent.
 - (ii) For long-term care individual policies or group certificates issued after August 1, 2004, the contract reserve may be established on a basis of separate mortality and other terminations, where the other terminations are not to exceed:
 - (I) For policy years one through four, the lesser of 80 percent of the voluntary lapse rate used in the calculation of gross premiums and eight percent;
 - (II) For policy years five and later, the lesser of 100 percent of the voluntary lapse rate used in the calculation of gross premiums and four percent.

Where a morbidity standard specified in 11 NCAC 11F .0207 is on an aggregate basis, such morbidity standard may be adjusted to reflect the effect of insurer underwriting by contract duration. The adjustments must be appropriate to the underwriting.

(2) Reserve Method:

- (A) For insurance except long-term care and return of premium or other deferred cash benefits, the minimum reserve is the reserve calculated on the two-year full preliminary term method; that is, under which the terminal reserve is zero at the first and also the second contract anniversary.
- (B) For long-term care insurance, the minimum reserve is the reserve calculated on the one-year full preliminary term method.
- (C) For return of premium or other deferred cash benefits, the minimum reserve is the reserve calculated as follows:
 - (i) On the one-year preliminary term method if such benefits are provided at any time before the 20th anniversary;
 - (ii) On the two-year preliminary term method if such benefits are only provided on or after the 20th anniversary.
- (D) 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 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) For long-term care insurance with nonforfeiture benefits, 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 standards specified in this Rule.

(c) 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 in this Rule, an insurer may use any reasonable assumptions as to interest rates, termination or 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 in this rule in determining a sound value of its liabilities under such contracts, including, but not limited to the following:

- (1) the net level premium method;
- (2) the one-year full preliminary term method;
- (3) prospective valuation on the basis of actual gross premiums with reasonable allowance for future expenses;
- (4) the use of approximations such as those involving age groupings, groupings of several years of issue, average amounts of indemnity, grouping of similar contract forms;
- (5) the computation of the reserve for one contract benefit as a percentage of, or by other relation to, the aggregated contract reserves exclusive of the benefit or benefits so valued; and
- (6) the use of a composite annual claim cost for all or any combination of the benefits included in the contracts valued.

(d) Annually, a 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 appropriate increments to such tabular reserves if such tests indicated that the basis of such reserves is no longer adequate; subject, however, to the minimum standards of 11 NCAC 11F .0205(b). If an insurer has a contract or a group of related similar contracts, for which future gross premiums will be restricted by contract, insurance department rules, or for other reasons, such that the future gross premiums reduced by expenses for administration, commissions and taxes will be insufficient to cover future claims, the insurer shall establish contract reserves for such shortfall in the aggregate.

*History Note: Authority G.S. 58-2-40; 58-58-50(k);
Temporary Adoption Eff. January 21, 1994 for a period of 180 days or until the Permanent Rule becomes effective, whichever is sooner;
Eff. April 1, 1994;*

Amended Eff. August 1, 2004;

Pursuant to G.S. 150B-21.3A, rule is necessary without substantive public interest Eff. December 20, 2015.