



AMERICAN ACADEMY of ACTUARIES

Objective. Independent. Effective.™

July 15, 2019

Actuarial Standards Board
1850 M Street NW, Suite 300
Washington, DC 20036-5805

Via email: comments@actuary.org

Re: Proposed Revision of Actuarial Standard of Practice (ASOP) No. 2, *Nonguaranteed Elements for Life Insurance and Annuity Products*

To Whom It May Concern:

The Life Practice Council of the American Academy of Actuaries,¹ has formed a Task Force to review the proposed revision of Actuarial Standard of Practice (ASOP) No. 2, *Nonguaranteed Elements for Life Insurance and Annuity Products* (the “exposure draft”).

In general, we support the addition of guidance to ASOP No. 2. The current ASOP is light on detail and we agree with the Actuarial Standards Board’s (ASB) decision to review and revise it. Nonguaranteed elements (NGEs) are core elements in many life insurance and annuity products in the industry, so it is critical that we have a strong standard for appropriate actuarial practice.

Although we support the efforts to revise ASOP No. 2, we believe the exposure draft needs a fair amount of work as described in the following comments.

We have organized our comments into three parts: (1) overall comments that apply to the entire exposure draft; (2) responses to your specific questions; and (3) specific comments that apply to particular sections of the exposure draft.

PART I: OVERALL COMMENTS

Prescription

ASOPs are intended to identify appropriate procedures and techniques for actuarial work.² They are not intended to impose requirements that are more restrictive than current rules and

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.

² Actuarial Standards Board, “About ASB.” Accessed at <http://www.actuarialstandardsboard.org/about-asb/>.

regulations. In general, we believe the language is too prescriptive throughout many sections of the exposure draft. For example:

- The requirement that NGEs should be revised only if anticipated experience factors have changed seems too prescriptive. Although this is a common circumstance precipitating NGE changes, the Task Force believes that it is overly prescriptive and may place an actuary in a difficult circumstance if contractual policy language specifies otherwise or if the actuary's role as a board member, regulator, or receiver/liquidator necessitates important additional considerations.
- Requiring that the profit pattern by duration after a redetermination never exceeds the profit pattern at original determination seems overly prescriptive. This requirement is not only more restrictive than what is commonly required by regulation and contract language, but it would also be difficult (if not impossible) to implement in practice. For example:
 - A simple change to the credited interest rate (that reflects a corresponding change to the earned interest rate) can change the profit pattern in many ways. Increases/decreases can change the amount at risk, therefore changing the profit patterns that emerge for the cost of insurance charges (and vice versa).
 - Flexible premium plans have different premium payment scenarios with unique profit patterns. The overall expectation of profit patterns could therefore change due to a different mix of premium scenarios emerging.
 - This restriction might effectively change policy guarantees by making it impossible to redetermine nonguaranteed elements at or toward the policy guarantees if such changes would adversely change the profit pattern. This could have a significant effect on guarantees and reserves (both under traditional statutory reserving and under principle-based reserving [PBR]).

Ambiguity

ASOPs are intended to both establish a basis for discipline as well as provide an actuary evidence of appropriate professional performance for defense in any civil or professional disciplinary action.³ Thus, it is important that the ASOP is clear on its face and unambiguous. We believe there is language in the exposure draft that is open to interpretation, which creates risks for practicing actuaries. For example:

- We believe “recouping past losses and distributing past gains” could be interpreted in multiple ways and should not be included in the ASOP without a clear definition.
- We believe the pattern of profits requirement could also be interpreted in multiple ways. For example, would the pattern of profits requirement apply in aggregate? By policy class? For a given premium scenario? Are profits defined in dollar amounts or in relation to some projected plan factor (e.g., percent of premiums)?
- The descriptions of the actuary's role in setting and applying the determination policy appear very distant and disconnected, as though the exposure draft is written for a consultant and not a company actuary.

³ *Id.*

- The language could create impossible situations for a company actuary without providing an acceptable course of action (e.g., what the actuary should do when applying a determination policy that does not align with the guidance of the ASOP).
- It is unclear whether the exposure draft differentiates between more routine NGE changes (e.g., changes to credited rates due to market interest movements) and more complex NGE changes (e.g., changes to cost of insurance [COI] rates).
- Some of the language seems to apply to only life insurance or only annuities but does not so state (e.g., Section 3.3.1e applies to life insurance only).
- In some places, the content seems repetitive, which can cause ambiguity where similar concepts are repeated using different language (e.g., do Section 3.2.2, *Applying the Determination Policy*, and 3.4, *Determining NGEs*, need to be in different sections?).

Recommended Additional Guidance

We recommend the ASB consider adding the following types of guidance to the ASOP.

- *Reinsurance considerations when setting NGEs.* Some company determination policies reflect reinsurance while others may not. We recommend adding guidance on reinsurance considerations without prescribing that actuaries should or shouldn't include it.
- *PBR techniques.* Today, most insurers are pricing new life products under a PBR framework. The ASOP should address how this is to be handled in the future. For example, if a product priced pre-PBR is now redetermined post-PBR, should a principle-based approach be used or considered? Conversely, does a PBR-oriented approach need to be used for redetermination? Should the actuary consider reserve changes when the Valuation Manual is updated (e.g., new mortality tables for the Net Premium Reserve)?
- *Sources of pricing information.* What should an actuary do if absolutely no original pricing information can be found? Are there sources of information that the actuary should reference (e.g., experience studies, reinsurers, valuation documentation, documentation for another similar block of business, industry surveys, reverse engineer profitability from original rates)?
- *Selecting profitability metrics for redetermination.* We recommend adding guidance for selecting profitability metrics for redetermination in light of the fact that certain profitability metrics better capture certain characteristics (e.g., emergence of profit, premium patterns, consistency with company practice). The actuary should consider a range of profitability metrics and choose and document those that best reflect those characteristics.

Navigation

We found it difficult to find the content we were looking for during our review and discussion. Part of this may be due to some of the repetition we've noted—many section headings seem to be similar. Another cause may be the lengthy headings, which have too many words to quickly skim. It was also difficult to read the ASOP with so many sub-sub-sub- levels.

PART II: RESPONSES TO SPECIFIC QUESTIONS

1. Are there any areas where the guidance is inconsistent with current practice? If so, please explain or provide examples.

Recouping past losses and distributing past gains is a company-specific or public policy decision. Regulator and/or shareholder views on this practice may change over time. Thus, we believe Section 3.2 is too rigid. Furthermore, because non-actuarial company executives and board members are not bound by ASOPs, the guidance in sections 3.2 and 3.4 could potentially put the actuary in an impossible position.

In addition, requiring that the profit pattern by duration after a redetermination never exceeds the profit pattern at original determination imposes a requirement that is inconsistent with current actuarial practices (except in New York under Regulation 210).

2. Are there areas where the guidance creates issues with any NGE regulatory requirements? If so, please explain or provide examples.

The National Association of Insurance Commissioners (NAIC) model Unfair Trade Practices Act allows the payment of bonuses or abatement of premiums out of surplus accumulated from nonparticipating insurance.⁴ This seems to conflict with Section 3.2 in the exposure draft.

PART III: SPECIFIC COMMENTS

As requested in the transmittal memorandum, we have not embedded our specific comments in the exposure draft. Although we have done our best to be clear in the comments that follow, some comments may be difficult to understand. We would be happy to discuss any of these comments with you if you seek clarification.

| # | Section | Comment |
|---|---------|---|
| 1 | 1.2 | Does this ASOP apply prospectively, i.e., to policies sold on/after a certain date? If applied to enforce policies, this ASOP could impose significant changes to management practices that would not have been anticipated during initial product pricing. |
| 2 | 1.2 | The inclusion of illustrations of NGEs in the first paragraph of 1.2 and in Section 3.5 is confusing and does not seem appropriate. Although current NGEs can impact illustrated NGEs, illustrated NGEs should not be in the scope of this ASOP because they are covered in ASOP No. 24, Model Regulation 582, Model Regulation 245, or other regulations (variable illustrations). |
| 3 | 1.2 | Shouldn't this ASOP mention the Pricing ASOP? |
| 4 | 1.2 | "This standard applies to actuaries when performing actuarial services with respect to determination." Does this scope include an actuary acting as a senior leader, a board member, or a receiver/liquidator? These roles may be filled by actuaries but they are not performing actuarial services. |
| 5 | 2.1 | Include premium persistency and cost of capital. |

⁴ NAIC Model 880, Section 4, Subsection H, Paragraph (2)(a).

| # | Section | Comment |
|----|---------|---|
| 6 | 2.1 | Anticipated Experience Factors could be used by a consultant or non-insurer. Recommend delete “by an insurer.” Recommend search for “by an insurer” throughout and remove where unnecessary. |
| 7 | 2.2 | Recommend combining this definition with the NGE framework definition. Add “how policy classes are established, and the practices used to determine NGE scales,” and delete the definition of NGE framework. Most determination policies already include these features, and most of the references to NGE framework throughout the ASOP are more appropriately references to determination policy. |
| 8 | 2.2 | We do not understand what is meant by “guidelines for drafting policy product provisions.” Is this referring to actual policy provisions that describe NGEs? |
| 9 | 2.3 | Recommend changing Guaranteed Policy Factor to Guaranteed Policy Element to be consistent with NGE. Alternately, the ASB may consider the term “NGE Limit.” |
| 10 | 2.3 | Remove “minimum cash values” because they do not limit NGEs, they limit the effect of an NGE. Change “maximum policy loan interest rates” to “maximum policy loan charges” to differentiate between credits and charges. Add “maximum premium loads” and “maximum administrative charges.” |
| 11 | 2.4 | Why specify “credited interest in excess of the minimum” and then not specify “charges lower than maximums?” Neither is necessary. Recommend deleting “in excess of the minimum.” |
| 12 | 2.4 | Recommend making list parallel to examples in 2.3. |
| 13 | 2.5 | Recommend deleting this term and combine with determination policy (see above). |
| 14 | 2.6 | Recommend deleting this term and address clarification in the Scope section. No need to make “policy” bold throughout the ASOP because it is a simple term. |
| 15 | 2.8 | Recommend delete this term because a clear definition is not integral to its use throughout the ASOP. |
| 16 | 2.9 | This definition seems incomplete. Recommend adding issue ages, and underwriting classes to the COI example. It is also unclear throughout the ASOP: When the term “NGE Scale” is used, does the guidance exclude NGEs that are not scales (e.g., interest rates)? |
| 17 | 3.1 | Recommend moving “The actuary should consider how the NGE framework has been applied in the past in relation to the actuarial services requested, if available” into the list of considerations and moving “If, in the actuary’s professional judgment, the NGE framework is incomplete or needs to be updated to reflect the current environment, the actuary should recommend that the NGE framework should be completed or updated” to the end of the section. |
| 18 | 3.1 | Add “the cost of implementing changes” and “reserve requirements” to the list of considerations. |
| 19 | 3.1a | Recommend using the defined term “establishing policy classes” vs. “grouping policies” |
| 20 | 3.2 | Language seems contradictory: “The actuary MAY provide advice...” is followed by “The actuary SHOULD provide advice...” The second sentence would be clearer if it were flipped. “Advice provided by the actuary on ... should be consistent with the following:” |

| # | Section | Comment |
|----|---------|--|
| 21 | 3.2a | The current draft refers to revisions of NGEs for inforce products (emphasis added). The Task Force suggests that the term “inforce products” be replaced with the more accurate term, “inforce policies.” This is because existing, or currently sold, products can relate to both newly issued policies and inforce policies. This same comment applies to the use of the term “inforce products” in sections 3.2b, 3.2.1(f), 3.3.2, and 3.4.2. Further, the Task Force recommends that the terms “revised” or “revision(s)” be replaced here and elsewhere with the term “redetermined” or “redetermination” because redetermination indicates an underlying analysis and consistent with the content of the ASOP. |
| 22 | 3.2a | Current language in the draft indicates that NGEs for inforce business should be revised only if anticipated experience factors have changed since issue or since the previous revision. Although this is a common circumstance precipitating NGE changes, the Task Force believes that it is overly prescriptive and may place an actuary in a difficult circumstance if contractual policy language specifies otherwise or if the actuary’s role as a board member, regulator, or receiver/liquidator necessitates important additional considerations. The Task Force suggests more expansive language that allows for other circumstances in which an actuary could recommend NGE revisions, while continuing to appropriately fulfill their obligations to the public, policyholders, and their client company. |
| 23 | 3.2b | The addition of specific language prohibiting “recouping past losses or distributing past gains” is a new element of the exposure draft that does not appear in the current ASOP. In fact, the current ASOP does not specifically mention “recouping past losses or distributing past gains” at all, except to say in the Current Practices Appendix that the treatment of past losses or past gains may be a part of a company’s Determination Policy. The Task Force believes that if specific limitations on “recouping past losses or distributing past gains” is to be added to the revised ASOP, this term should be defined. It is not a self-defining term and many interpretations could be offered as to what the term means. |
| 24 | 3.2b | Further to the need to define “recouping past losses or distributing past gains,” the definition will need to clarify at what level the limitation applies—that is, at the individual policy level, the policy class level, the overall policy form level, at the individual NGE level, or something else. |
| 25 | 3.2.1 | The provision in connection with providing advice on developing or modifying a Determination Policy that the actuary “should provide advice consistent with the following,” in advance of listing six components, could be difficult for an actuary to comply with if the six components are not internally consistent. For example, marketing objectives may not be consistent with the applicable law or policy provisions. Thus, the Task Force suggests modifying the lead-in language in Section 3.2.1 to say “the actuary should consider the following” and adding commentary on what the actuary should do in the event that the components are incongruous. |

| # | Section | Comment |
|----|-------------------------|---|
| 26 | 3.2.1b and 3.2.1c | Typically, a Determination Policy is a high-level set of guidance and principles and does not discuss specific experience assumptions or anticipated experience factors. We recommend clarification that the policy describes a process rather than specific assumptions or factors, such as: “how the reasonable expectations ... will be used” and “how the variability and credibility ... will be recognized.” |
| 27 | 3.2.1e | We recommend deleting size and reasonableness of margins because they are a senior management or board/owners’ decision. |
| 28 | 3.2.2 | Not all NGE determination is the determination of a “scale.” For example, credited rates and index parameters are not scales. We recommend clarification of what guidance applies to “scales” vs. all NGEs. Perhaps add clarification in the definition of NGE scales if the intent is to omit certain types of NGEs. If this was not the intent, recommend stating in the definition of NGE that an NGE might be a single element or a scale, and then using the defined term NGE throughout the document (vs. NGE Scale). |
| 29 | 3.2.2a | This is confusing because the determination policy does not have assumptions. |
| 30 | 3.2.2c | We question why reserve requirements are specifically called out when there are many factors that are not specifically called out (e.g., expense assumptions, federal income tax [FIT] rates). |
| 31 | 3.2.2f | The lead-in to this list states that the actuary should be familiar with NGE framework so (f) seems redundant. |
| 32 | 3.2.2 | What should the actuary do after the discussion with the insurer? This guidance seems incomplete and could put the actuary in an impossible position. |
| 33 | 3.3.1 | Recommend changing this to a list of considerations vs. conditions because these conditions are too prescriptive for an ASOP. |
| 34 | 3.3.1 | We recommend moving the content of the last paragraph to the list of considerations as items (f) through (i). |
| 35 | 3.3.1e | Is this language applicable for annuity contracts? Many actuaries expect that they will combine annuity portfolios in future durations. |
| 36 | 3.4 | If company management rejects the actuary’s advice on the determination policy and then the actuary needs to follow the determination policy when determining NGEs, this would seem to create a conflict with 3.2 a and b. |
| 37 | 3.4.1 | The title of 3.4.1 is a good example of the awkwardness that is created by referring to products vs. policies. We recommend simply referring to the determination policy for new policies or new policy sales instead of referring to a “New Product or Future Sales of an Existing Product.” |
| 38 | 3.4.1f | In this section, as well as in 3.4.2.1 and 3.4.2.4c, there is a somewhat ambiguous reference that sounds like a redetermined future stream of profits cannot exceed an original stream of future profits on a duration-by-duration basis. Although this type of requirement appears in one state regulation (NY Reg 210), it has created a lot of issues and questions about whether it is a reasonable requirement to impose and whether it is even practical. We recommend eliminating the reference to patterns of profit because it is only required in one state and creates unnecessary challenges for the actuary. |
| 39 | 3.4.1f | Depending on the final approach to section 3.4.2.4c, the reference to section 3.4.2.4c may need to be changed here. |

| # | Section | Comment |
|----|-----------------|---|
| 40 | 3.4.1 | We recommend deleting “The actuary should document the expected profitability, including the pattern of profits by duration” because it is already included in (a-f) referenced in previous sentence. |
| 41 | 3.4.1 and 3.4.2 | We believe the organization of 3.4.1 and 3.4.2 causes some content challenges in this ASOP. Specifically, we do not think it is valuable to have one section for new products and another for inforce products. Instead, it seems like it would be more valuable to describe what to do when there is relevant experience for the determination exercise vs. when there is not (e.g., when designing a completely new type of benefit). |
| 42 | 3.4.2.2 | As an example of the previous comment, we do not believe Section 3.4.2.2 should apply only to inforce products because the actuary may have relevant experience for new products, too. |
| 43 | 3.4.2.3f | For some policies issued in the 1980s that have undergone NGE and administrative system changes, old NGEs are simply not available due to historical reasons or mergers and acquisitions. Is there any guidance for this situation? |
| 44 | 3.4.2.3g | The second sentence could be misinterpreted to be a restriction vs. an example of limited review. Perhaps add “choose to” to help clarify: “the actuary may choose to look only at...” |
| 45 | 3.4.2.3j | Should the actuary take policyholder impact into account when making a recommendation? This might be a more appropriate consideration for senior management because the actuary probably can’t base their recommendation on this. |
| 46 | 3.4.2.4a | Recommend identifying the anticipated experience factors and policy classes. |
| 47 | 3.4.2.4b | Recommend basing changes on the anticipated experience factors and policy classes. |
| 48 | 3.4.2.4c | Prospective profitability decisions are made by senior management or boards/owners. If actuaries attempt to make these decisions without senior management direction (or are required to by following an ASOP), then these decisions will be taken away from actuaries. Actuaries can determine and disclose the impact of NGE revisions but shouldn’t be limited like this. We recommend that the actuary should consider the pattern of profits but not be bound by them. |
| 49 | 3.4.2.4c | In addition, the original scales and experience factors may be unavailable so that the original pattern can’t be recreated. The exposure draft does not provide guidance in this section for such a circumstance. |
| 50 | 3.5 | Please see Comment 2 regarding illustrated NGEs. |
| 51 | 4 | Why did you omit the guidance in 4.1 of the current ASOP? |
| 52 | A1 | In the Appendix 1 Background Section, we believe litigation should be added as another reason for renewed interest in NGE redetermination. |

We hope these comments are helpful. Please contact Ian Trepanier, the Academy's life policy analyst (trepanier@actuary.org), if you have any questions.

Sincerely,

Laura Hanson, MAAA, FSA
Chairperson, ASOP No. 2 Task Force
American Academy of Actuaries

Task Force to Review ASOP No. 2, *Nonguaranteed Elements for Life Insurance and Annuity Products*

Laura Hanson, MAAA, FSA, Chairperson
Mary Bahna-Nolan, MAAA, FSA
Sue Bartholf, MAAA, FSA
Matt Monson, MAAA, FSA
Tim Pfeifer, MAAA, FSA
Chuck Ritzke, MAAA, FSA
Jim Thompson, MAAA, FSA
Zegang Zhu, MAAA, FSA