ACTUARIAL STANDARDS BOARD

**• EXPOSURE DRAFT •**

**Proposed Revision of
Actuarial Standard
of Practice
No. 2**

# Nonguaranteed Elements for Life Insurance and Annuity Products

**Comment Deadline:
July 15, 2019**

**Developed by the
Task Force to Revise ASOP No. 2 of the
Life Committee of the
Actuarial Standards Board**

**Approved for Exposure
by the Actuarial Standards Board
March 2019**

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**EXPOSURE DRAFT—March 2019**

March 2019

**TO:** Members of Actuarial Organizations Governed by the Standards of Practice of the Actuarial Standards Board and Other Persons Interested in Nonguaranteed Elements for Life Insurance and Annuity Products

**FROM:** Actuarial Standards Board (ASB)

**SUBJ:** Proposed Revision of Actuarial Standard of Practice (ASOP) No. 2

This document contains the exposure draft of a proposed revision of ASOP No. 2, now titled *Nonguaranteed Elements for Life Insurance and Annuity Products*. Please review this exposure draft and give the ASB the benefit of your comments and suggestions. Each written comment letter or e-mail received by the comment deadline will receive consideration by the drafting committee and the ASB.

The ASB accepts comments by either electronic or conventional mail. The preferred form is e-mail, as it eases the task of grouping comments by section. However, please feel free to use either form. If you wish to use e-mail, please send a message to **comments@actuary.org**. You may include your comments either in the body of the message or as an attachment prepared in any commonly used word processing format. **Please do not embed your comments in the exposure draft and do not password protect any attachments**. **If the attachment is in the form of a PDF, please do not "copy protect" the PDF**. Include the phrase "ASB COMMENTS" in the subject line of your message. Please note: Any message not containing this exact phrase in the subject line will be deleted by our system's spam filter. Also, please indicate in the body of the e-mail if your comments are being submitted on your own behalf or on behalf of a company or organization.

If you wish to use conventional mail, please send comments to the following address:

ASOP No. 2 Revision
Actuarial Standards Board
1850 M Street, NW, Suite 300
Washington, DC 20036-5805

The ASB posts all signed comments received to its website to encourage transparency and dialogue. Comments received after the deadline may not be considered. Anonymous comments will not be considered by the ASB nor posted to the website. Comments will be posted in the order that they are received. The ASB disclaims any responsibility for the content of the comments, which are solely the responsibility of those who submit them.

For more information on the exposure process, please see the ASB Procedures Manual.

**Deadline** for receipt of responses in the ASB office: **July 15, 2019**

History of the Standard

In 1986, the Interim Actuarial Standards Board adopted the original version of ASOP No. 2, which was titled *The Redetermination (or Initial Determination) of Non-Guaranteed Charges and/or Benefits for Life Insurance and Annuity Contracts*. In 1990, the ASB adopted a reformatted version of ASOP No. 2. (Prior to 2013, ASOP No. 2 was numbered ASOP No. 1.)

In 1995, the ASB adopted ASOP No. 24, *Compliance with the NAIC Life Insurance Illustrations Model Regulation*, which was created in conjunction with the National Association of Insurance Commissioners' (NAIC) *Life Insurance Illustrations Model Regulation* (the *Model*). The *Model* itself was drafted to accomplish specific regulatory objectives. ASOP No. 24 provides guidance for compliance with the *Model*. With respect to illustrated nonguaranteed elements (NGEs) for life insurance policies and annuity products that are not subject to or represented as being in accordance with the *Model*, the 2004 revision of ASOP No. 2 imposed new obligations on the actuary.

Since ASOP No. 2 was last updated in 2004, there has been increased attention to the practices insurers use to determine and manage NGEs within individual life insurance and annuity products. The ASOP is being updated to reflect current practices and provide additional guidance on the determination of NGEs. In developing this exposure draft, the task force reviewed and incorporated concepts from documents that supported the development of the original version of this ASOP in 1986.

Notable Changes from the Existing ASOP

Notable changes made in the exposure draft include the following:

1. Clarification of the scope (section 1.2);

2. Expansion and clarification of definitions (section 2);

3. Introduction of the concept of an insurer's NGE framework, which includes the determination policy, how policy classes are established, and the practices used to determine NGE scales (section 3.1);

4. Expansion of guidance for advising on the actuarial aspects of the determination policy (section 3.2), including advice that is consistent with the following:

   - NGEs for in-force products are revised only if the anticipated experience factors have changed since issue or since the previous revision, and

   - NGEs for in-force products are not revised with the objective of recouping past losses or distributing past gains;

5. Expansion of guidance for establishing or making changes to policy classes (section 3.3);

6. Expansion of guidance for determining NGE scales with additional detail to align with the determination policy guidance (section 3.4);

7. Expansion of guidance for recommending NGE scales used in illustrations (section 3.5);

8. Addition of new guidance for regulatory opinions and disclosures (section 3.6);

9. Addition of new guidance for relying on data or other information supplied by others (section 3.7) and relying on assumptions provided by others (section 3.8);

10. Addition of documentation requirements (section 3.9) to address expanded guidance throughout section 3; and

11. Addition of new disclosure requirements (section 4).

Request for Comments

The ASB appreciates comments and suggestions on all areas of this proposed standard. Rationale for any suggested changes would be helpful.

In addition, the ASB would like to draw the readers' attention to the following questions:

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

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

The ASB voted in March 2019 to approve this exposure draft.

The ASB would like to acknowledge the contributions of task force member Kevin Reopel, who passed away prior to the draft being exposed.

*The Actuarial Standards Board (ASB) sets standards for appropriate actuarial practice in the United States through the development and promulgation of Actuarial Standards of Practice (ASOPs). These ASOPs describe the procedures an actuary should follow when performing actuarial services and identify what the actuary should disclose when communicating the results of those services.*

# ACTUARIAL STANDARD OF PRACTICE NO. 2

# NONGUARANTEED ELEMENTS FOR LIFE INSURANCE AND ANNUITY PRODUCTS

## STANDARD OF PRACTICE

### Section 1. Purpose, Scope, Cross References, and Effective Date

1.1 Purpose—This actuarial standard of practice (ASOP) provides guidance to actuaries when performing actuarial services with respect to the determination of **nonguaranteed elements** (NGEs) for life insurance and annuity products, including riders attached to such products. Throughout this standard, the term *determination* includes both initial determination and subsequent redeterminations, where appropriate.

1.2 Scope—This standard applies to actuaries when performing actuarial services with respect to the determination and, if applicable, illustration of **NGEs** (except as provided below) for life insurance and annuity products written on individual **policy** forms where **NGEs** may vary at the discretion of the insurer. The standard also applies to group master contracts with individual certificates where **NGEs** are determined in a similar manner to products written on individual life and annuity **policy** forms. Examples of products within the scope of this standard include universal life, indeterminate premium life, and deferred annuity products. Such products may be fixed, variable, or indexed.

Group products with **NGEs** that are not determined in a similar manner to those written on individual life and annuity **policy** forms are not in scope. Two examples are traditional group term life insurance and certain retirement funding products (for example, synthetic guaranteed interest contracts). To the extent that a product does not clearly fall into the scope just described, the actuary should use professional judgment to determine whether the product is in scope.

This standard does not apply to actuaries when performing actuarial services with respect to policyholder dividends, which are covered by ASOP No. 15, *Dividends for Individual Participating Life Insurance, Annuities, and Disability Insurance*. To the extent that a product involves both **NGEs** and policyholder dividends, this standard applies with respect to **NGEs**, and ASOP No. 15 applies with respect to policyholder dividends.

This standard does not apply to actuaries when performing actuarial services with respect to the initial determination or subsequent redeterminations of any **NGE** in a reinsurance contract.

This standard does not apply to actuaries when performing actuarial services with respect to illustrations of **NGEs** subject to ASOP No. 24, *Compliance with the NAIC Life Insurance Illustrations Model Regulation*.

If the actuary departs from the guidance set forth in this standard in order to comply with law (statutes, regulations, and other legally binding authority), or for any other reason the actuary deems appropriate, the actuary should refer to section 4. If a conflict exists between this standard and applicable law, the actuary should comply with applicable law.

1.3 Cross References—When this standard refers to the provisions of other documents, the reference includes the referenced documents as they may be amended or restated in the future, and any successor to them, by whatever name called. If any amended or restated document differs materially from the originally referenced document, the actuary should consider the guidance in this standard to the extent it is applicable and appropriate.

1.4 Effective Date—This standard is effective for all actuarial work performed on or after four months after adoption by the Actuarial Standards Board.

## Section 2. Definitions

The terms below are defined for use in this actuarial standard of practice and appear in bold throughout the ASOP.

2.1 Anticipated Experience Factor—An assumption of future experience that may be used by an insurer in the determination of **NGEs**. Examples of **anticipated experience factors** include rates of investment income, mortality, morbidity, taxes, **policy** persistency, cost of reinsurance, and expense.

2.2 Determination Policy—The insurer's principles or objectives for determining **NGEs**. For example, the **determination policy** could include the insurer's governing principles and requirements, profitability objectives, capital requirements, guidelines for drafting product provisions, and requirements for and frequency of reviews of **NGEs** on in-force products.

2.3 Guaranteed Policy Factor—A premium, value, charge, or benefit that limits an **NGE**. **Guaranteed policy factors** are specified in the **policy**. Examples of **guaranteed policy factors** include minimum cash values, minimum credited interest rates, maximum cost of insurance charges, maximum gross premiums, minimum index parameters, maximum mortality and expense charges, and maximum **policy** loan interest rates.

2.4 Nonguaranteed Element (NGE)—Any premium, charge, or benefit within an insurance **policy** that affects **policy** costs or values, is not guaranteed in the **policy**, and can be changed at the discretion of the insurer. An **NGE** may provide a more favorable value to the policyholder than an element that is guaranteed in the **policy**. Examples of nonguaranteed charges or benefits include credited interest in excess of the minimum guaranteed rate, cost of insurance (COI) charges, bonuses, indeterminate premiums, index parameters, and expense charges.

2.5 NGE Framework—The combination of the **determination policy**, how **policy classes** are established, and the practices used to determine **NGE scales**.

2.6 Policy—An individual life insurance **policy** or annuity contract or group life insurance and annuity certificate with **NGEs** that operate in substantially the same manner as an individual life insurance **policy** or an individual annuity contract with respect to **NGEs**.

2.7 Policy Class—**Policies** that are grouped together for the purposes of determining an **NGE**.

2.8 Profitability Metric—A measurement used to assess a product's expected level of financial results.

2.9 Scale—A series of premiums, charges, or benefits. For example, a COI **scale** would be determined across all ages and durations.

## Section 3. Analysis of Issues and Recommended Practices

3.1 NGE Framework—The actuary should understand the insurer's **NGE framework**, if any, in relation to the actuarial services requested. The actuary should consider how the **NGE framework** has been applied in the past in relation to the actuarial services requested, if available.

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** be completed or updated.

Examples of items that the actuary should understand include the following:

a. the methodology for grouping **policies** when evaluating experience;

b. the methodology for developing **anticipated experience factors**;

c. the frequency for review of **anticipated experience factors** and **policy classes**;

d. the methodology for allocating income and costs;

e. the models or methods used;

f. the distribution strategy, target markets, and competitive objectives;

g. the objectives used in setting **profitability metrics**;

h. the methodology for determining capital requirements; and

i. the insurer's governance process, including the decision and approval process.

3.2 Issues and Considerations when Providing Advice on the Actuarial Aspects of the Determination Policy—The actuary may provide advice on 1) developing or modifying the **determination policy**, or 2) applying the **determination policy**.

The actuary should provide advice on developing, modifying, or applying the **determination policy** that is consistent with the following:

a. **NGEs** for in-force products are revised only if the **anticipated experience factors** have changed since issue or since the previous revision; and

b. **NGEs** for in-force products are not revised with the objective of recouping past losses or distributing past gains.

3.2.1 Providing Advice on Developing or Modifying the Determination Policy—When advising an insurer on developing or modifying its **determination policy**, the actuary should provide advice consistent with the following:

a. the **policy** provisions and applicable law;

b. the actuary's reasonable expectations of future experience;

c. the variability and credibility of each **anticipated experience factor** determined over a period of time;

d. the insurer's marketing objectives;

e. reasonable margins for profitability and capital requirements; and

f. periodic review of **NGEs** in in-force products. For example, some jurisdictions may impose a maximum time period between successive insurer reviews of **NGEs**.

The actuary should document the sources of the **determination policy** used in developing the advice. For example, portions of the **determination policy** may be found in the insurer's governance processes, corporate policies, or operating practices.

3.2.2 Providing Advice on Applying the Determination Policy—The actuary may be asked to advise on applying the **determination policy** for determining initial **NGE scales**, evaluating whether to revise existing **NGE scales**, or revising existing **NGE scales**.

When advising on how to apply the **determination policy**, the actuary should be familiar with the **NGE framework** and should take into account the following:

a. the need to make additional assumptions because the **determination policy** has insufficient detail;

b. **guaranteed policy factors**, options, and other relevant provisions of the **policy**;

c. impacts on or from reserving requirements;

d. applicable law (including, for example, for variable products, any constraints or other requirements imposed by applicable securities law);

e. resources available; and

f. the insurer's goals, including marketing and financial objectives.

If, in the actuary's professional judgment, the actuary believes that the **determination policy** may be inconsistent with the guidance in sections 3.2 and 3.2.1, the actuary should discuss the matter with the insurer.

3.3 Establishment of or Changes to Policy Classes—When preparing for an assignment, the actuary should review the existing **policy classes** for the product or similar products within the insurer's **NGE framework**.

3.3.1 For a New Product or for Future Sales of an Existing Product—If the **policy classes** have not been defined in the **NGE framework**, or if the **policy classes** may be, in the actuary's professional judgment, incomplete or inconsistent with the items below, the actuary should recommend the establishment of or changes to the **policy classes** that meet the following conditions:

a. developed consistently with the guidance in section 3.2 of ASOP No. 12, *Risk Classification*;

b. are appropriate for each **NGE** (A particular **policy** may be assigned to one or more **policy classes** at issue based on **anticipated experience factors** and **NGEs**, for example, one **policy class** for credited interest and a different **policy class** for COI charges.);

c. appropriately reflect differences in **anticipated experience factors** (for example, smoker versus nonsmoker);

d. are refined appropriately to mitigate antiselection; and

e. do not anticipate that further modifications would be made after issue.

When recommending **policy classes**, the actuary should take into account the **policy** provisions, the structure of **guaranteed policy factors** and **NGEs**, the time period over which **policies** are issued (for example, **policies** issued before or after a particular date could be in distinct **policy classes**), and the underwriting characteristics and marketing objectives for the product.

3.3.2 For In-Force Products—The actuary should recommend that **policies** remain assigned to their **policy classes**, unless there is new information that is material to the **anticipated experience factors** and supports reassigning the **policies** to different **policy classes**. For example, a change in one state's premium tax that affects some **policies** within a **policy class** differently than it affects others could justify reassigning such **policies** to a different **policy class**.

In addition, the actuary may recommend combining **policy classes** if, in the actuary's professional judgment, such combinations would be appropriate. For example, if the experience for a **policy class** is not credible, the **policy class** could be combined with other **policy classes** for the purposes of determining **anticipated experience factors**.

When recommending a change in the assignment of **policies** to **policy classes**, the actuary should follow the guidance in section 3.3.1.

3.4 Determination Process for NGE Scales—When determining **NGE scales** for a product in accordance with the **NGE framework**, the actuary should take into account the determination **policy** and the following:

a. the appropriateness of the models, methods, and **profitability metrics**;

b. the relationship of **NGE scales** to **anticipated experience factors**;

c. the consistency of **NGE scales** with **policy** provisions, including rider provisions;

d. any limits on **NGE scales** due to regulatory constraints;

e. any limits on **NGE scales** due to **guaranteed policy factors**; and

f. the relationship of **NGE scales** to reserves, capital, and surplus.

The actuary should also take into account illustration requirements when determining **NGE scales**.

The actuary may consider using approximation methods, such as smoothing and interpolation, when determining **NGE scales**.

3.4.1 Determination Process for a New Product or for Future Sales of an Existing Product—When determining **NGE scales** for a new product or for future sales of an existing product, the actuary should take into account the following:

a. whether the **anticipated experience factors** reflect the new product's features, intended markets, distribution methods, underwriting procedures, and **policy classes** (as established in accordance with the guidance in section 3.3.1);

b. how **NGE scales** are structured to cover costs under the product design and the potential impact on profitability if policyholder behavior varies from expectations;

c. that **NGE scales** are determined with the expectation that they will not be revised unless the **anticipated experience factors** change;

d. whether the **NGE scales** are consistent with the language of the **policy**;

e. constraints on the ability to revise **NGE scales** to reflect future changes in **anticipated experience factors** (for example, **guaranteed policy factors**, contractual limitations, development and implementation cost, systems constraints); and

f. the expected profitability, including the pattern of profits by duration and how the guidance in section 3.4.2.4(c) may constrain the ability to revise **NGE scales** after issue.

The actuary may use prior analysis in the determination of the **NGE scales**, if appropriate.

The actuary should document the **NGE** determination process, including how items (a-f) were considered. The actuary should document the expected profitability, including the pattern of profits by duration.

The actuary should consider conducting sensitivity analysis to evaluate the impact of future deviations from the anticipated experience. The actuary should consider recommending how often such **anticipated experience factors** be reviewed.

3.4.2 Determination Process for In-Force Products—The determination process for in-force products consists of reviewing prior determinations, analyzing emerging experience, considering whether to recommend a revision in the **NGE scales**, and, if a revision is to be made, determining the revised **NGE scales**.

3.4.2.1 Reviewing Prior Determinations—The actuary should review prior determinations, including the original determination in effect at the time of **policy** issue. This includes information such as previous **anticipated**

**experience factors**, **profitability metrics**, pattern of profits, **NGE scales**, and other assumptions.

If the information related to prior determinations is not available or incomplete, the actuary should reconstruct prior determinations to the extent necessary and practicable, and document the methods and assumptions used. If reconstructing the prior determinations is not practicable due to incomplete information or other limitations, the actuary should select and document a reasonable approach to gain an understanding of the prior determination.

3.4.2.2 Analyzing Experience—When analyzing experience, the actuary should take into account relevant conditions and circumstances such as the following:

a. the time elapsed since the last analysis of experience;

b. the credibility of experience;

c. the size of the relevant group of **policies** or **policy classes**, such as number of **policies**, premium volume, insurance amount, or account value;

d. the materiality of any change in the experience relative to the existing **anticipated experience factors**;

e. whether projected trends underlying existing **anticipated experience factors** are supported by experience; and

f. whether profitability was particularly sensitive to changes in any **anticipated experience factors**, as disclosed in previous actuarial reports.

The actuary should recommend that the **anticipated experience factors** be updated, if warranted by the results of the analysis.

3.4.2.3 Considering Whether to Recommend a Revision to NGE Scales—When considering whether to recommend a revision to **NGE scales**, the actuary should take into account the following:

a. time elapsed since **NGE scales** were last reviewed;

b. deviations in emerging experience from the prior determination of **NGE scales**;

c. whether any additional assumptions beyond the **anticipated experience factors** need to be updated to be consistent with emerging experience;

d. effects of changes in reserve and capital requirements, and taxation;

e. the appropriateness of the **profitability metrics** and objectives. For example, an internal rate of return metric used at issue may not be appropriate when applied to in-force products;

f. prospective profitability using the updated **anticipated experience factors** and any other updated assumptions relative to that which would be expected based on the original **anticipated experience factors**;

g. the complexity of the analysis needed, which will depend on the **anticipated experience factors** and the type of revision being considered. For example, when changing credited interest rates, the actuary may look only at changes in investment income. Other changes, such as COIs, may require more complex analysis and modeling, which could reflect multiple **anticipated experience factors** and require consideration of other **NGEs**;

h. whether other analyses, such as sensitivity analysis, are needed;

i. costs, practical implementation difficulties, and materiality of making revisions to the **NGE scale**; and

j. potential impacts on the policyholder or insurer of revising or not revising **NGEs** to reflect changes in **anticipated experience factors**.

The actuary should document the results of the analysis, whether the actuary recommends a revision or not.

3.4.2.4 <u>Determining the Revised NGE Scales</u>—When determining revised **NGE scales**, the actuary should take into account the provisions of section 3.4.1(b-f) and should take the following actions:

a. identify, under the terms of the **policy** and applicable law, the **anticipated experience factors** that may be used when revising **NGE scales**;

b. base the revision of the **NGE scales** on changes in the **anticipated experience factors** identified in (a) above; and

c. determine new **NGE scales** such that the prospective profitability from the time of revision, including the prospective pattern of profits by duration, is not greater than that using the original **NGE scales** and original **anticipated experience factors**, holding all other assumptions constant.

The actuary should perform an appropriate level of analysis based on the **anticipated experience factors** and the type of revision being considered. (For example, changing COIs may require more complex analysis and modeling than changing credited interest rates, as discussed in section 3.4.2.3[h].) The actuary may use relevant prior analysis in making the determination. The actuary should document the results of any analysis used to support the determination of the revised **NGE scales**.

3.5 NGEs Used in Illustrations—When recommending **NGE scales** to be used in an illustration not subject to ASOP No. 24, the actuary should follow applicable regulations, guidelines, and standards for illustrations, such as those that are based upon the following:

a. *Annuity Disclosure Model Regulation* (Model 245); and

b. *Variable Life Insurance Model Regulation* (Model 270) and NAIC Actuarial Guideline 15.

The actuary should not recommend illustrated **NGE scales** that are more favorable to the policyholder than those produced in accordance with section 3.4. The actuary should consider conducting tests of illustrated **NGE scales** to ascertain whether the illustrated **NGE scales** are supportable using **anticipated experience factors** that are not more favorable than actual recent historical experience.

3.6 Providing Regulatory Opinions and Disclosures—When providing regulatory opinions and disclosures relating to **NGEs**, or actuarial services in support of such opinions and disclosures, the actuary should be knowledgeable about the requirements and information necessary to support the opinion or disclosure. Such information may include some or all of the following for the relevant products:

a. the insurer's **NGE framework**;

b. the requirements of applicable law;

c. the determination process, including how experience and financial results are emerging; and

d. previous regulatory filings.

3.7 Reliance on Data or Other Information Supplied by Others—When relying on data or other information supplied by others, the actuary should refer to ASOP No. 23, *Data Quality*, for guidance.

3.8 Reliance on Assumptions or Methods Provided by Another Party—When relying on assumptions or methods provided by another party, the actuary should refer to ASOP No. 41, *Actuarial Communications*. The actuary should disclose the extent of any such reliance in the actuarial report.

3.9 Documentation—In addition to the documentation requirements throughout the rest of section 3, the actuary should consider preparing and retaining documentation to support compliance with the remaining requirements of section 3 and the disclosure requirements of section 4. When preparing documentation, the actuary should prepare documentation in a form such that another actuary qualified in the same practice area could assess the reasonableness of the actuary's work or could assume the assignment if necessary. The degree of such documentation should be based on the professional judgment of the actuary and may vary with the complexity and purpose of the actuarial services. In addition, the actuary should refer to ASOP No. 41, *Actuarial Communications*, section 3.8, for guidance related to the retention of file material other than that which is to be disclosed under section 4.

## Section 4. Communications and Disclosures

4.1 Required Disclosures in an Actuarial Report—When issuing an actuarial report to which this standard applies, the actuary should refer to ASOP Nos. 12, 23, and 41. In addition, the actuary should disclose the following in such actuarial reports (if applicable):

a. any recommendations that were made with respect to developing, completing, or updating the **NGE framework** (see section 3.1);

b. advice the actuary provided on developing or modifying the **determination policy** (see sections 3.2 and 3.2.1);

c. advice the actuary provided on how to apply the **determination policy**, including any advice that deviated from the **determination policy** in order to follow the guidance in 3.2 or 3.2.1 or that deviated from the guidance in sections 3.2 or 3.2.1 in order to comply with the **determination policy**, and the rationale for such deviations (see section 3.2.2);

d. recommendations made by the actuary to establish or change **policy classes** for future sales (see sections 3.3.1 and 3.4.1[a]);

e. recommendations made by the actuary for reassignment of in-force **policies** to different **policy classes** (see section 3.3.2);

f. a description of the **anticipated experience factors** used in the determination of **NGEs** and any changes to such factors since any prior determination (see section 3.4.1 and 3.4.2);

g. a description of any material constraints on the ability to revise **NGE scales** (see sections 3.4.1[e] and [f] and 3.4.2.4[c]);

h. results, observations, or recommendations from the determination process for **NGE scales** for a new product or for future sales of an existing product, including results and observations from any profitability analysis or sensitivity analysis (see section 3.4.1);

i. observations from the analysis that indicate that the profitability is particularly sensitive to changes in certain **anticipated experience factors** (see sections 3.4.1 and 3.4.2.4);

j. any use of prior analysis (see section 3.4.1 and 3.4.2.4);

k. any reconstructed prior determinations or reasonable approaches used when reconstructing the prior determinations was not possible (section 3.4.2.1);

l. observations or recommendation to revise or not revise in-force **NGE scales**, including results from any profitability or sensitivity analysis (see section 3.4.2.3);

m. results, observations, or recommendations from the determination process used to support any revisions to **NGE scales** for in-force products, including results and observations from any analysis (including any material change in the prospective pattern of profits by duration for the new **NGE scale** compared to the original **NGE scale**) (see section 3.4.2.4); and

n. results from tests performed to ascertain whether illustrated **NGE scales** are supportable when using **anticipated experience factors** that are not more favorable than actual recent historical experience (see section 3.5).

4.2 <u>Additional Disclosures in an Actuarial Report</u>—The actuary should also include the following disclosures, when applicable, in an actuarial report:

a. the disclosure in ASOP No. 41, section 4.2, if any material assumption or method was prescribed by applicable law (statutes, regulations, and other legally binding authority);

b. the disclosure in ASOP No. 41, section 4.3, if the actuary states reliance on other sources and thereby disclaims responsibility for any material assumption or method selected by a party other than the actuary; and

c. the disclosure in ASOP No. 41, section 4.4, if, in the actuary's professional judgment, the actuary has otherwise deviated materially from the guidance of this ASOP.

## Appendix 1

## Background and Current Practices

*Note*: This appendix is provided for informational purposes and is not part of the standard of practice.

### Background

In the mid-1970s, activity increased with respect to individual life and annuity products with nonguaranteed elements (NGEs) as opposed to dividends under traditional participating policies.

Because of the increased activity on these products, they came to represent significant market share and financial significance, and it was deemed necessary to develop an actuarial standard of practice in this area. Thus, the Interim Actuarial Standards Board adopted the original version of ASOP No. 1 in October 1986. (Prior to 2013, ASOP No. 2 was known as ASOP No. 1.) The Actuarial Standards Board adopted a reformatted version of ASOP No. 1 in 1990.

In 1986, the policies in question were still evolving, and there was little standardization in such areas as benefit design, pricing structure, marketing practices, and investment philosophies. It was therefore impossible for the standard to offer guidance on these issues. Rather, the standard reflected that the actuary's essential obligations were (1) to assure the completion of all activities required to advise the client professionally; and (2) to prepare an actuarial communication for the client presenting this advice.

By the early 2000s, the volume of these products sold had continued to grow, and considerable product innovation had taken place. ASOP No. 1 was revised to reflect this new environment. It was also revised to be consistent, where appropriate, with newer standards ASOP No. 15, *Dividend Determination for Participating Individual Life Insurance Policies and Annuity Contracts*, and ASOP No. 24, *Compliance with the NAIC Life Insurance Illustrations Model Regulation*. The resulting revision of ASOP No. 1 was adopted in March 2004.

In May 2011, ASOP No. 1 was updated for deviation language, and in March 2013, it was renumbered ASOP No. 2.

In recent years, further developments affecting products with NGEs have taken place, such as the following:

- continued product evolution, including index features, persistency bonuses, living benefit riders, secondary guarantees, and new ancillary benefits;
- advances in actuarial techniques for modeling, stochastic testing, and sensitivity analysis;
- changes in life insurance company taxation, reserve valuation, and capital requirements;

- enhancement of insurer governance procedures with respect to the determination of NGEs; and

- increased regulation of NGEs, such as the promulgation of New York Regulation 210 in March 2018.

In response to such developments, actuarial practices have evolved, and ASOP No. 2 has been updated to reflect these changes.

## Current Practices

The actuary may provide professional services in three principal areas with respect to NGEs. The actuary is normally involved in the determination of NGE scales in accordance with insurer determination policy. The actuary may also be involved in advising the insurer on setting the determination policy or the establishment of or changes to policy classes. When determining NGEs, the actuary considers corporate governance practices, policy administration, regulation, marketing objectives, and consumer expectations, among other factors.

The actuary may be called upon to determine NGE scales for a new product or for future sales of an existing product, or to recommend revising NGE scales for in-force products. Although the steps needed to complete these two broad categories of assignments have many common elements, there are significant differences with respect to the principles, methodologies, and criteria that are commonly followed.