



ACTUARIAL STANDARDS BOARD

October 2014

TO: Members of Actuarial Organizations Governed by the Standards of Practice of the Actuarial Standards Board and Other Persons Interested in the Application of the Actuarial Standards of Practice in Regard to Life Insurance and Annuity Pricing

FROM: Actuarial Standards Board (ASB)

SUBJ: Request for Comments – Life Insurance and Annuity Pricing ASOP

This document contains a request for comments concerning the development of an Actuarial Standard of Practice (ASOP) that would apply to actuaries when pricing new and in-force life insurance and annuity products. Please review this letter and provide the ASB the benefit of your comments and suggestions. Each written response and each response sent by e-mail to the address below will be acknowledged, and all responses will receive appropriate consideration by 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 topic. 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 password protect any attachments. If the attachment is in the form of a PDF, please do not “copy protect” the PDF.** Please include the phrase “Life Insurance and Annuity Pricing ASOP” in the subject line of your message.

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

Life Insurance and Annuity Pricing ASOP
Actuarial Standards Board
1850 M Street, NW, Suite 300
Washington, DC 20036-4601

Deadline for receipt of comments in the ASB office: December 15, 2014

The ASB will post all signed comments received by the deadline to its website. Unsigned or anonymous comments will not be considered by the ASB nor posted to the website. The comments will not be edited, amended, or truncated in any way. Comments will be posted in the order that they are received. Comments will be removed when final action on a proposed

standard is taken. The ASB website is a public website and all comments will be available to the general public. The ASB disclaims any responsibility for the content of the comments, which are solely the responsibility of those who submit them.

Background

The pricing of products is one of the most important functions actuaries perform. At the current time, there are a number of standards that are specifically related to ratemaking for Property/Casualty Insurance, and pricing is considered in a few Health standards. In addition, the ASB currently has projects in progress related to Property/Casualty and Health ratemaking.

The situation for life insurance and annuity pricing is different. As for other forms of insurance, a number of standards provide guidance for work related to pricing. Examples of current ASOPs that relate to life insurance and annuity pricing include the following:

1. ASOP No. 2, [*Nonguaranteed Charges or Benefits for Life Insurance Policies and Annuity Contracts*](#) (revised March 2004, updated for deviation language May 2011, and renumbered March 2013)
2. ASOP No. 7, [*Analysis of Life, Health, or Property/Casualty Insurer Cash Flows*](#) (revised June 2002 and updated for deviation language May 2011)
3. ASOP No. 12, [*Risk Classification \(for All Practice Areas\)*](#) (revised December 2005 and updated for deviation language May 2011)
4. ASOP No. 15, [*Dividends for Individual Participating Life Insurance, Annuities, and Disability Insurance*](#) (revised March 2006 and updated for deviation language May 2011)

But while there are standards on several functions related to pricing life and annuity products, there is no standard that provides guidance on pricing itself. The ASB notes that actuaries are at the forefront of developing and pricing new products. Having a standard in place may have been beneficial to actuaries pricing the early generations of complex products such as variable annuities with guaranteed benefit riders, indexed annuity products, and secondary guarantee universal life products.

As outlined below, such a standard could provide guidance on a number of topics that are not currently covered in actuarial standards and where guidance would be helpful. The intent of the proposed ASOP would be to supplement the guidance provided by the current set of ASOPs.

Scope and Content of Proposed ASOP

The proposed ASOP would address the pricing of life insurance and annuity products, both individual and group product types. The proposed standard would focus on the actuary performing profitability analysis when pricing new and in-force products, but not the actuary's

role in developing the product's design, marketing plan, investment strategy implementation, etc. The term "pricing" would include establishing premiums, charges, fees, and other revenue elements, some guaranteed and others non-guaranteed, to cover benefits, services, and expenses arising from the insurance contract. Management adjustments to pricing would not be included in the scope of the proposed ASOP. Depending on the circumstances, the actuary may disclose these adjustments.

Section 3 of the proposed ASOP ("Analysis of Issues and Recommended Practices") could include guidance in the following areas.

- a. Coverage and Product Features – would provide general guidance necessary prior to beginning the pricing exercise. An example of such guidance is, "the actuary should be aware of and take into consideration all pertinent coverages or benefits found in the insurance product being priced."
- b. Developing the Model Framework – would provide guidance on establishing the model used in the pricing process. Examples of other items to be addressed in this section are the development of the pricing cells for which to price, model horizon, accounting basis, deterministic vs. stochastic, cost of capital, etc.
- c. Selecting and Using the Profitability Analysis Methodology – would provide the framework for selecting the methodology used to quantify the risk and return elements from the pricing model (internal rate of return, profit margin, return on assets, etc.).
- d. Assumption Setting – would provide guidance for selecting assumptions. For example, whether and to what extent mortality improvement should be used, reflecting credibility in the assumptions, setting policyholder behavior in a new product design, etc.
- e. Risk – would provide guidance in evaluating the risks associated with the product being priced in regard to contract guarantees and other elements of the contract.
- f. Sensitivity Analysis – would provide guidance in performing sensitivity analysis of reasonable variations in assumptions prior to finalizing the assumptions and making a final pricing recommendation.
- g. Controls – would provide guidance regarding the proper controls the actuary should have in place to ensure that the model and the pricing process work as intended. Controls should exist around the data used from administrative systems, experience studies, and within the pricing model.
- h. Pricing Recommendation – would provide guidance in addressing issues faced when making a recommendation on the pricing of benefits or services offered. For example, whether past losses can be covered by future premium increases or whether one source of profit can be used to subsidize another.
- i. Documentation – would provide guidance on maintaining and providing documentation

of the product pricing processes.

- j. Compliance – would provide guidance regarding the actuary’s responsibility to be aware of regulations, laws, and standards that would affect the pricing of a product, such as state’s non-forfeiture laws, suitability requirements, Illustration Actuary regulations, the definition of life insurance, and other IRS regulations, etc.
- k. Disclosure – would provide guidance on disclosures such as the actuary’s concerns if, in the actuary’s opinion, a product design is not fair and equitable to the policy owner, in addition to the standard disclosure requirements.

Request for Comments

The ASB is interested in the views of actuaries and other parties involved in pricing life insurance and annuity products on a range of subjects related to this proposed standard. In particular, we would like to hear views related to the following:

1. Would an ASOP on life insurance and annuity pricing be beneficial to the profession?
2. Are there areas where appropriate practice needs to be defined or current practice needs to be improved? If so, what are those areas?
3. Does the proposed ASOP cover the appropriate subject areas? If not, what changes do you suggest?
4. How should the proposed ASOP interact with existing ASOPs that provide guidance regarding policyholder dividends and other nonguaranteed elements?

The ASB reviewed this Request for Comments in September 2014 and approved its issuance.