

William H. Wilton

Wilton579@sbcglobal.net

Comment #5 – 12/16/13 – 2:59 p.m.

December 16, 2013

Principle-Based Reserves
Actuarial Standards Board
1850 M Street, NW, Third Floor
Washington, DC 20036

Re: Principle-Based Reserves for Life Products – Proposed ASOP

I appreciate the effort the committee has put into this exposure draft on principle-based reserves. Since the valuation manual will not be effective for some time, we have the opportunity to make sure the issues are properly addressed in this proposed standard of practice.

Section 1

I think the first issue that needs to be addressed is the scope of this proposed standard. Does it apply to only products subject to VM-20? Its title states “Principle-Based Reserves for Life Products”. VM-00 describes that “Life Insurance Products” as Section VM-20 but goes on to exclude certain types of life contracts that include credit life, preneed life, and annuities. The standard of practice should not assume that the actuary will recognize that the title of the standard is similar to the title of VM-20 and therefore should only be applied to VM-20. Furthermore, Section 1.2 defines scope to include reserves for individual life insurance policies, where such reserves are represented as being in compliance with the provisions of the Standard Valuation Law and the Valuation Manual governing principle-based reserves. Does this give the impression that VM-21 is included? The definition of life insurance in VM-01 includes annuities.

For the remainder of my comments, I am assuming that this proposed standard is only for principle-based reserves subject to VM-20.

I would like to confirm that the Actuarial Standards Board does not anticipate adopting this standard of practice until the Valuation Manual actually becomes effective.

Section 2

I have a concerns with a number of definitions as follows:

- Asset Segmentation Plan – I think this definition needs to be removed. It is inconsistent with VM-20 and the verbatim restatement in section 3.5.1a. It implies an insurer segments business for reporting investment income for statutory purpose. From my perspective, insurers segment to align their asset management with groups of liabilities for a variety of reasons including risk management, not for statutory reporting. Furthermore, the valuation manual states asset segmentation plan or approach used to allocate investment income for statutory purposes. Therefore, I think the valuation manual did not intend for asset segmentation plan to be linked to statutory reporting.
- Credibility – I think the parenthetical should be eliminated. I believe the profession knows how to interpret “predictive value”.
- Granularity – I recommend deleting the second sentence. I believe definitions should exclude commentary.
- Modeling Cell – Should this be stated as “Model Cell” to be consistent with Model Segment?
- Qualified Actuary – Is this definition correct? Why would the Academy use a term different from how it is commonly understood by its members? The Academy should not use qualified actuary as anything other than meeting the qualification standards set by the Academy. I recommend removing this definition.
- Risk Factor – Is asset return a risk factor or an outcome? I recommend deleting asset return.
- Valuation Date – The definition is inconsistent with VM-01. I recommend using the VM-01 definition.

Section 3

In Section 3.2, should “Actuarial Services” be used as defined in ASOP 1?

In Section 3.5.1a., as defined in Section 2, isn’t “approach used to allocate investment income for statutory purposes” the same as “asset segmentation plan”? As recommend previously, I recommend deleting the definition in Section 2

In Section 3.5.3a., the actuary should consider additional valuation procedures such as:

performing a dynamic validation of the model that involves comparing the cash flows produced by the model to the actual historical data to verify that the model produces results reasonably similar to those actually experienced;

Why is this a consideration? To the extent the model uses prescribed assumptions or assumptions with margins, there should not be an expectation of reasonably similar amounts to those actually experienced.

In Section 3.7a., Section 3.7b., and Section 3.7c., why is “recent experience” specified. Shouldn’t the actuary determine the relevance of all available data and make an evaluation based on their professional training for its use? Is credible used appropriately? Isn’t experience credible? I believe it’s the weight of predictive value we are going to attach to the experience that guides the assumption and not if the experience is credible (believable) or not.

As to the specific task force question:

1. The text sometimes repeats or summarizes material in VM-20 to the extent needed to clarify the guidance. Is this overdone or, conversely, should there be more of it?

Overdone. VM-20 should not be restated in the actuarial standard of practice. Unless it is guidance on what an actuary should do when performing actuarial services in support of principle-based reserves, the guidance should be removed. Actuarial Standards of Practice should not be restating, interpreting, or implying additional requirements to VM-20. As stated in ASOP 1 – Section 3.1 ASOPs identify what should be considered, done, documented, and disclosed when rendering actuarial services.

2. Is the guidance provided, particularly in the areas listed below, clear and appropriate? If not, what specific changes do you suggest?

- making updating adjustments when data prior to the valuation date is used;

I think the requirements should be restated in bullet form to clarify what the requirements are:

- disclose why the use of such data will not produce a material change compared to using data as of the valuation date
- the nature of any updating adjustment made to the data
- rationale for why the adjustments are appropriate

I personally find the last two sentences of Section 3.5.6 peculiar. If the adjustments do not result in an appropriate minimum reserve, prior period data would not be used. Isn’t the concept better documented as a consideration? For example, the actuary should consider whether the use of prior period data is appropriate? The current wording seems to imply that the actuary would do something inappropriate – knowingly set an inappropriate minimum reserve. Am I interpreting this correctly? I recommend deleting the last two sentences.

- doing stochastic analysis of nonproportional reinsurance;

- grouping policies into modeling cells; or

I think the guidance for modeling cells is inappropriate. Sections 3.5.5a.1. and 3.5.5a.2. appear to be items better suited for a practice note than actuarial standards.

I was unable to find the following in VM-20. “The actuary should disclose the results of any tests used to demonstrate that the use of a model with a higher level of granularity would be unlikely to result in a materially higher minimum reserve.” Are these actuarial standards redefining the requirements of VM-20? This statement, while unnecessary, also appears to not be entirely consistent with Section 2.G. of VM-20.

- deciding on model granularity.

I did not observe any guidance on granularity.

3. Is this standard of practice appropriately prescriptive?

It is difficult to understand what is the actuarial standard of practice and what is a restating of VM-20. As mentioned above, I feel VM-20 language should be stripped out so that it is clear what this proposed actuarial standard of practice is advising the actuary to consider, do, document or disclose.

4. If adopted, do you feel that this standard of practice provides adequate guidance for actuaries responsible for determining principle-based reserves? If not, what changes would you suggest?

I do not feel this standard of practice provide adequate guidance. If VM-20 is stripped out of this actuarial standard, is there any substance left? I think for this actuarial standard to provide adequate guidance it has to be concise to what should be considered, done, documented, and disclosed when rendering actuarial services.

I would like to thank the committee for the opportunity to comment on this exposure draft. I think the committee needs better articulate what proposed standards are being recommended. As currently drafted, it was not clear what, if any, standards are newly created that an actuary should be aware of when providing actuarial services for VM-20.

Sincerely,

William H. Wilton, FSA, MAAA