

## Appendix 2

### Comments on the Exposure Draft and Task Force Responses

The exposure draft of this revised actuarial standard of practice was issued in September 2000 with a comment deadline of March 31, 2001. (Copies of the exposure draft are available from the ASB office.) Twenty-one comment letters were received. The Cash Flow Testing Task Force of the Life Committee of the ASB carefully considered all comments received. Summarized below are the significant issues and questions contained in the comment letters and the task force's responses.

<b>SECTION 1. PURPOSE, SCOPE, CROSS REFERENCES, AND EFFECTIVE DATE</b>	
<b>Section 1.2, Scope</b>	
Comment	A number of commentators asked for clarification whether the analysis can be for part of an insurer's asset, policy, or other liability cash flows. One commentator did not want the standard to allow testing of only assets or liabilities.
Response	The revised ASOP No. 7 allows testing of asset, policy, or other liability cash flows individually or only in part, as appropriate. The task force added wording in section 1.2 to clarify the point.
Comment	A few commentators believed that section 1.2 should specifically mention items that are relevant in today's practice, namely determination of capital adequacy (such as the C-3 RBC tests that were required for some companies for the first time in 2000) and determination of fair value.
Response	The task force agreed that capital adequacy is relevant for today's practice, but believed that fair value is not defined well enough, so the task force added only capital adequacy to the list of items.
Comment	A few commentators asked whether ASOP No. 7 was appropriate for property/casualty insurance and health benefit plans.
Response	The task force notes that a joint property/casualty and life task force originally developed ASOP No. 7, which continues to be appropriate for certain property/casualty work and for health benefit plans.
Comment	One commentator questioned the relevance of ASOP No. 7 for non-U.S. work.
Response	Annotation 3-1 of the Code of Professional Conduct requires the actuary to observe applicable standards of practice promulgated by a recognized actuarial organization for the jurisdiction in which the actuary renders actuarial services. ASOPs promulgated by the Actuarial Standards Board apply to actuarial services rendered in the United States. Actuarial services rendered in a non-U.S. jurisdiction would be subject to actuarial standards of practice promulgated by such jurisdiction's recognized actuarial organization, if any. Therefore, the task force made no change as a result of this comment.
<b>SECTION 2. DEFINITIONS</b>	
<b>Section 2.2, Asset, and 2.11, Liability</b>	
Comment	Many commentators offered suggestions for changing these definitions.
Response	The task force believes the definitions are appropriate. The definitions are consistent with those found in other standards, where practical. The definitions in ASOP No. 7 are for just this standard and are appropriate for this standard.
<b>Section 2.5, Cash Flow Analysis, and 2.6, Cash Flow Testing</b>	
Comment	One commentator did not like the distinctions made between "cash flow analysis" and "cash flow testing."

Response	The task force believes the definitions are appropriate, since ASOP No. 7 is now designed to make a hierarchy of types of analysis, with “cash flow analysis” being the most general term, and “cash flow testing” being one type of cash flow analysis.
<b>Section 2.12, Notional Asset Portfolio</b>	
Comment	A number of commentators suggested changes to this definition.
Response	The task force revised the definition in response.
<b>Section 2.13, Other Liability Cash Flows</b>	
Comment	One commentator noted that the term “other liability cash flows” was used, but not defined, in the exposure draft of ASOP No. 22. A commentator on ASOP No. 22 thought that the definition should include surplus notes.
Response	The task force agreed and added a definition of “other liability cash flows,” which includes a reference to surplus notes, to both ASOP No. 7 and No. 22.
<b>Section 2.15, Policy Cash Flows (previously section 2.14)</b>	
Comment	One commentator noted that the definition did not treat premium taxes properly, as premium taxes are not paid on behalf of policyholders, but rather are paid as required by law.
Response	The task force agreed with this comment and changed the definition accordingly.
<b>SECTION 3. ANALYSIS OF ISSUES AND RECOMMENDED PRACTICES</b>	
<b>Section 3.2.1, Reasons for Cash Flow Testing, and 3.2.2, Cash Flow Testing is Not Always Necessary</b>	
Comment	A few commentators questioned the use of the phrases “long duration” and “short-term,” and noted that these can have meaning in a GAAP context.
Response	The task force agreed that the use of those phrases could cause confusion in that regard and changed the wording.
<b>Section 3.2.2, Cash Flow Testing is Not Always Necessary</b>	
Comment	One commentator asked that the phrase “policy term” be included as part of what the actuary should consider as to whether a block is relatively insensitive to changes in economic conditions.
Response	The task force agreed and added words to accomplish this.
<b>Section 3.2.3, Use of Analyses or Data Predating the Analysis Date</b>	
Comment	One commentator believed that the actuary should consider future material events in the analysis.
Response	The task force disagreed, believing such a thing is beyond the scope of cash flow analysis.
<b>Section 3.5.1, Policy Cash Flow Characteristics</b>	
Comment	One commentator asked that the issue of changes in the premium scales be included explicitly.
Response	The task force added section 3.5.1(f), which specifically identifies changes in premiums and other charges as items for the actuary to consider.
<b>Section 3.7, Materiality</b>	
Comment	A few commentators wanted further guidance on materiality. Several asked that materiality be mentioned in specific sections.
Response	The task force believes that more detailed guidance on materiality is beyond the scope of this standard. The task force notes that the guidance in section 3.7 is applicable to the entire standard, so it did not add specific mentions in other sections.
<b>Section 3.8, Reinsurance</b>	
Comment	One commentator asked whether section 3.8 differed from section 3.5.1(a).
Response	Section 3.5.1(a) specifically deals with policy cash flows, while section 3.8 is broader than that. The task force made no changes to either section.
<b>Section 3.9, Separate Accounts</b>	

Comment	A few commentators wanted more detailed guidance on treatment of flows between the general account and the separate account.
Response	The task force believes that the level of guidance in this section is appropriate. However, the task force agreed with a comment that the actuary should consider whether certain cash flows between the general and separate accounts were allowable, and changed the wording accordingly.
<b>Section 3.10.1, Scenarios</b>	
Comment	A number of commentators questioned the use of the word “often” in the sentence, “Often, more than one scenario will be analyzed.”
Response	The task force removed the word “often” and substituted the words “depending on the purpose of the analysis.”
Comment	Regarding 3.10.1(b), Number of Scenarios, one commentator wanted more detailed guidance on the number of scenarios. Another commentator wanted words that put less emphasis on the investment rate of return being the key item of interaction with asset, policy, or other liability cash flows.
Response	The task force believes that the level of guidance on the number of scenarios is appropriate. The task force did change this section to put less emphasis, when choosing the number of scenarios, on whether asset, policy, or other liability cash flows vary with investment rates of return.
<b>Section 3.10.2, Sensitivity Testing</b>	
Comment	A few commentators noted the issue of cash flows being more uncertain the further into the future a projection is done.
Response	The task force agreed and added words to section 3.10.2, noting more potential for variability the further into the future the cash flows are projected.
<b>Section 3.11, Negative Interim Earnings</b>	
Comment	One commentator mentioned that negative interim earnings were an accounting issue and that, therefore, this section should be eliminated.
Response	The task force disagreed. This section emphasizes the point that, if appropriate for the purposes of the analysis (for example, an asset adequacy test), the actuary should consider whether negative earnings in some years (the typical concern being the early projection years) affect whether future positive earnings in other (typically, later projection) years can be realized; i.e., the block tested may require the infusion of additional funds before the positive earnings years start. The task force agreed that in some types of analyses (for example, pricing and analyzing a new block of business where the company has significant surplus) the consideration of negative earnings may not be appropriate.

<b>SECTION 4. COMMUNICATIONS AND DISCLOSURES</b>	
<b>Section 4.1, Reliance on Others for Data, Projections, and Supporting Analysis</b>	
Comment	One commentator noted that wherever the term “data” was mentioned in terms of an actuary reviewing and using the work of others, it was more appropriate to use the more comprehensive terminology “data, projections, or supporting analysis.”
Response	The task force agreed and made the recommended change.
<b>Section 4.3, Documentation</b>	
Comment	Some commentators believed that section 4.3 should be more general and not contain a list of items needing documenting, while others liked the guidance a list gave.
Response	The task force agreed to keep the list, but shortened the descriptions of some of the items.
Comment	A few commentators noted that the amount of disclosure should vary based on the complexity of the project.
Response	The task force agreed and added wording to note this.
Comment	One commentator noted that a disclosure item should be added for analyses performed prior to the valuation date.
Response	The task force agreed and added what is now section 4.3(g).
Comment	One commentator noted that section 4.3(g)(15) (previously section 4.3(u)) on documentation of negative interim earnings should be modified to note that this should be done only if appropriate for the analysis.
Response	The task force believes this issue is covered by other wording in section 4.3, which notes that documentation should be appropriate for the analysis being done.
<b>Section 4.4, Retention</b>	
Comment	One commentator noted that there should be a section on document retention.
Response	The task force agreed and added a new section 4.4, Retention.

### **Appendix 3**

#### **Comments on the Revised Standard as Adopted in September 2001 and ASB Responses**

As appendix 2 indicates, the exposure draft of this revised actuarial standard of practice was issued in September 2000 with a comment deadline of March 31, 2001. The Cash Flow Testing Task Force of the Life Operating Committee of the ASB, after carefully considering all comments received, presented a proposed final revised standard to the ASB for adoption. At its September 2001 meeting, the ASB adopted the revised standard (with minor edits) with an effective date of April 15, 2002.

In March of 2002, representatives of the Casualty Practice Council of the American Academy of Actuaries identified concerns regarding the application of the revised standard to property and casualty practice. Specifically, they expressed concern that the scope of the revised standard went beyond generally accepted actuarial practice in the property and casualty area and, arguably, called for casualty actuaries to consider cash flow testing in settings where they typically would not do so and where, in their view, cash flow testing would not be needed.

In light of these concerns, the Casualty Practice Council formally requested that the ASB defer the effective date of the revised standard to July 15, 2002, in order to provide the Council with an opportunity to present its concerns and offer one or more suggested remedies. The ASB carefully considered the Casualty Practice Council's request and agreed to defer the effective date of the revised standard to July 15, 2002.

Representatives of the Casualty Practice Council attended the ASB's June 2002 meeting and presented the Council's concerns. The chairperson of the Life Operating Committee of the ASB was also present. After considerable discussion and consideration, the ASB agreed that it would be appropriate to do the following:

1. amend the scope of the revised standard to conform more closely to current, generally accepted practice among property and casualty actuaries;
2. proceed with such amended scope without re-exposure to the membership since the scope and content of the revised standard (as adopted at the September 2001 meeting) with respect to life and health practice remained unaltered; and
3. inform the membership and all interested parties of these developments and the effective date of July 15, 2002.

The Casualty Practice Council representatives also opined that section 3.2, Determining the Level of Analysis of Cash Flows, in requiring the actuary to consider "all material risks and options embedded in the asset, policy or other liability cash flows," was unclear as to what is or

is not “material.” The ASB agreed a clarification was appropriate for all practice areas, and modified the section to require the actuary to consider only those risks and options that the actuary believes to be material.