Appendix 2

Comments on the Exposure Draft and Committee Responses

The exposure draft of the proposed standard was circulated for review in May 1998, with a comment deadline of September 1, 1998. Eighteen letters of comment were received. The Closed Block Task Force and the Life Committee carefully reviewed each comment and made a number of changes in response. Summarized below are the significant issues and questions contained in the comment letters, printed in roman. The committee's responses appear in **boldface**.

General Comments

Several comment letters did not apply to any particular part of the exposure draft. One letter approved of the proposed actuarial standard of practice (ASOP); another letter disapproved of the proposed ASOP and of the concept of closed blocks. One letter suggested that a closed block should be funded with assets equal to liabilities and profit transfers made periodically. Another letter requested guidance on how to avoid a tontine. Another letter suggested that guidance should be given on reinsurance that should be secured by the closed block to avoid mortality fluctuations. **The committee did not make any change to the ASOP as a result of these letters.**

One letter requested guidance on spreading deviations of actual from expected experience over several years. **The committee felt that this question was beyond the scope of this ASOP.**

Transmittal Memorandum

In the exposure draft's transmittal memorandum, the committee drew its readers' attention to three provisions in particular: section 3.4, Funding Assumptions; section 3.4.1, Reinvestment Rate Assumption; and section 3.4.5, Taxes. Please see those sections, below, for discussion of any pertinent readers' comments and committee responses.

Two commentators objected to the term *full demutualization*, which appeared elsewhere in the transmittal memorandum. **The committee changed the term to *traditional demutualization*.** Three letters suggested recognizing protection methods other than closed blocks. **The committee acknowledges that there are other valid methods, but believes them to be beyond the scope of this ASOP.**

Section 1. Purpose, Scope, and Effective Date

Section 1.3, Effective Date—One commentator suggested that section 1.3 should encourage earlier implementation of the ASOP. **The committee changed the effective date at the ASB's direction.**

Section 2. Definitions

Five commentators requested a definition of *reasonable dividend expectations*. **The committee added such a definition (see section 2.7).** One letter commented on the definition of *individual policy* used; another letter requested a definition of *group policy*; a third suggested adding a definition of *initial liabilities*. **The committee edited the definition of *individual policy* (see section 2.3) slightly; decided not to define *group policy*; and added a definition of *initial liabilities* (see section 2.5).**

Section 3. Analysis of Issues and Recommended Practices

Section 3.2, Policy Inclusion Criteria—One commentator suggested that universal life insurance policies should be included in closed blocks and that the guidance on what policies should be included should be expanded. Several letters requested more examples. **The committee did not agree that more examples would clarify the proposed standard. The committee retained section 3.2 as written.**

Section 3.3, Determination of Funding—One letter suggested including due and accrued investment income in section 3.3. **The committee edited section 3.3 to include such income.** Two letters suggested editorial changes to section 3.3. **Some of the suggested editorial changes appear in the revised text.**

Section 3.4, Funding Assumptions—In the exposure draft's transmittal memorandum, the committee asked for comment on this section as follows:

> *Section 3.4, Funding Assumptions, states that the assumptions should be consistent with the recent experience underlying the current dividend scale. An alternative position could be that the assumptions should be consistent with the experience underlying the dividend scale at the last time it was approved by the board of directors, which may have been several years ago. The Life Committee believes that the approach set forth in the exposure draft is preferable, but welcomes comments.*

No comment letters directed to this point were received and the committee believes that the approach taken by the standard is appropriate.

One letter suggested that section 3.4 specifically refer to the possible use by a closed block of a slice of a larger portfolio. **Language has been added to the definition of *initial assets* (see section 2.4) to accommodate this suggestion.**

Several letters suggested editorial changes. **The committee adopted some suggested changes to improve clarity.**

Section 3.4.1, Reinvestment Rate Assumption (now titled Reinvestment Rate)—In the exposure draft's transmittal memorandum, the committee asked a specific question about this section as follows:

> *Section 3.4.1, Reinvestment Rate Assumption, provides for an adjustment to the reinvestment rate assumption if the investment policy for assets to be purchased for the closed block is different from the investment policy underlying the current dividend scale (i.e., the dividend scale in effect immediately prior to the establishment of the closed block). This statement implies that if the closed-block's cash flows are to be invested in assets significantly different, in type or maturity pattern, from assets underlying the current dividend scale, the reinvestment rate should be modified. For example, the investment policy might state that closed-block investments are not to include a substantial common stock component that underlies the current scale, or that closed-block assets are to be invested in debt instruments of significantly shorter maturities than those underlying the current scale. Should the ASOP provide more guidance in this area?*

One comment letter objected to the approach taken in the exposure draft to setting the reinvestment rate when the investment policy of the closed block differed from that underlying the current dividend scale. **The committee made two changes in response to this letter:**

1. **The committee added the following sentences:**

   Usually, policyholders would not expect that the company's investment policy for new assets would change as a result of the establishment of the closed block. Therefore, policyholders' reasonable dividend expectations are most likely to be met if the investment policy for new assets to be purchased with the closed block's cash flows is the same as the investment policy underlying the current dividend scale.

2. **The committee replaced a requirement that the actuary consider any change in investment policy with a requirement that the actuary fully disclose the effect of any non-recognition of a change in investment policy.**

One letter suggested that where the experience had changed dramatically since the dividend scale was set, but before the closed block was funded, current experience, rather than the experience underlying the dividend scale, should be used. **The committee found this to be inconsistent with the purpose and design of a closed block and made no change.**

Section 3.4.2, Mortality and Morbidity—One letter indicated that the commentator thought that section 3.4.2 referred to the dividend mortality rather than to the mortality underlying the dividend scale. **The committee believes that the meaning is clear.**

Section 3.4.4, Commissions and Expenses—One letter suggested that expenses should always be funded by the closed block. This is contrary to current practice. **The committee made no change.**

Section 3.4.5, Taxes—The committee had explicitly asked for comment on this section in the exposure draft's transmittal memorandum as follows:

> *Section 3.4.5, Taxes, does not discuss the treatment of the IRC Section 809 so-called equity tax on mutual insurance companies. Historically, this tax (even if it is still payable) has not been charged to the closed block in the operating rules and therefore has been ignored in the funding calculations.*
>
> *Some dividend scales contain either an implicit or explicit charge to reflect the equity tax. The Life Committee considered whether the operating rules should specify making this charge to the closed block under the tax allocation procedures, provided the company was still subject to the equity tax. If the company were not subject to the equity tax, this charge would not be allocated to the closed block. Under this approach (which has not to our knowledge been followed in any transaction), the charge would be assumed in the closed-block funding calculations so that if and when the company were no longer subject to the equity tax, the closed-block policies would benefit to the extent they had been previously charged. The ASB Life Committee believes that the approach set forth in the exposure draft is preferable, but welcomes comments.*

No letters on this point were received and the committee believes that the approach taken in the ASOP is appropriate.

A number of commentators made editorial suggestions, particularly with respect to section 3.4, Funding Assumptions, and section 3.5, Operating Rules. **The committee considered all editorial suggestions and adopted a number of them.**

The Closed Block Task Force and the Life Committee of the ASB thank everyone who took the time and made the effort to submit comments.