

## Appendix 2

### Comments on Exposure Draft and Responses

The exposure draft of this proposed ASOP, *Principle-Based Reserves for Life Products*, was issued in June 2013 with a comment deadline of December 16, 2013. Seven comment letters were received, some of which were submitted on behalf of multiple commentators, such as by firms or committees. For purposes of this appendix, the term “commentator” may refer to more than one person associated with a particular comment letter. The Principle-Based Reserve Task Force carefully considered all comments received, reviewed the exposure draft, and proposed changes. The Life Committee and the ASB reviewed the proposed changes and made modifications where appropriate.

Summarized below are the significant issues and questions contained in the comment letters and responses.

The term “reviewers” in appendix 2 includes the Principle-Based Reserves Task Force, the Life Committee, and the ASB. Also, unless otherwise noted, the section numbers and titles used in appendix 2 refer to those in the exposure draft.

GENERAL COMMENTS	
Comment	One commentator asked for more guidance related to the calculation of the net premium reserve (NPR) and identified several areas where additional guidance would be helpful (shadow accounts, universal life secondary guarantee, ceded reinsurance credits, etc.).
Response	The reviewers note that the calculation of the NPR is outside the scope of this standard and made no change.
Comment	One commentator suggested that if the pre-tax interest maintenance reserve (PIMR) instructions in the current draft of VM-20 are not amended, additional guidance on the PIMR calculation would be helpful.
Response	The reviewers understand that there is currently a proposal to amend VM-20 with respect to PIMR and will consider whether any changes to this ASOP should be made following resolution of that proposal.
Comment	One commentator asked for clarification of an appropriate assumption for the “working reserve” noting that the term is not used in VM-20 but is used in RBC C3 Phase 3.
Response	The reviewers believe that clarifying an assumption not mentioned in this standard for the purpose indicated is outside the scope of this ASOP and, therefore, made no change.
Comment	Two commentators pointed out that VM-20 is an evolving document and, even after it is adopted, revisions may be frequent, suggesting that a process for revising the standard in response is needed.
Response	The reviewers agree that changes to the <i>Valuation Manual</i> may require changes to this ASOP. At this time, the ASB plans to update this ASOP, if needed, using existing processes.

Comment	One commentator suggested that guidance be included to address the difficulties companies could have when reporting practices (segments, etc.) apply to both PBR and non-PBR reserves.
Response	The reviewers believe that this subject would be more suitable in a practice note. Therefore, the comment was referred to the Life Practice Council for consideration.
Comment	One commentator recommended clarifying that the <i>Valuation Manual</i> requires compliance from the company, whereas this ASOP provides guidance to actuaries.
Response	The reviewers agree with this recommendation and added language to section 1 and the transmittal memorandum.
<b>TRANSMITTAL MEMORANDUM QUESTIONS</b>	
<b>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?</b>	
Comment	In general, commentators thought that the repetition of material from VM-20 was overdone. Enhancements ranging from complete elimination of all repetition to limiting the repetition to only those areas where additional guidance is being provided were suggested. It was also suggested that, when material is being extracted from VM-20, it be clearly identified.
Response	The reviewers reviewed the material in the exposure draft that was repeated or summarized from VM-20 and either eliminated the material or, if it was determined that the material was helpful to the user, made some wording changes to clarify that the material was from VM-20. In particular, major changes were made in sections 3.3, 3.7, and 3.7.1. Section 3.5.4 was eliminated entirely. Significant changes were also made in several other sections, including 3.1, 3.4, 3.5.1, 3.5.2, 3.5.6, 3.6, 3.7.2, 3.7.3, and 3.7.4.
<b>Question 2: Is the guidance provided, particularly in the areas listed below, clear and appropriate? If not, what specific changes do you suggest?</b>	
<ul style="list-style-type: none"> <li>• making updating adjustments when data prior to the valuation date is used;</li> <li>• doing stochastic analysis of nonproportional reinsurance;</li> <li>• grouping policies into modeling cells; or</li> <li>• deciding on model granularity.</li> </ul>	
Comment	Most commentators responding to this question felt that the guidance in the areas identified could be clarified and, in some cases, strengthened and made suggestions about how to do so.
Response	The reviewers made a number of changes to the pertinent sections of the exposure draft (principally sections 3.5.6 and 3.6.3) to incorporate those suggestions as appropriate.
<b>Question 3: Is this standard of practice appropriately prescriptive?</b>	
Comment	Commentator responses to this question were sparse but evenly divided.
Response	The reviewers considered the prescriptiveness of each specific element of guidance and, in some instances, made changes.
<b>Question 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?</b>	
Comment	Commentator responses to this question were sparse but evenly divided.
Response	The reviewers adjusted the guidance based on all of the comments received and believe that, by so doing, the guidance provided is improved.

<b>SECTION 1. PURPOSE, SCOPE, CROSS REFERENCES, AND EFFECTIVE DATE</b>	
<b>Section 1.2, Scope</b>	
Comment	One commentator suggested that the scope of the standard clearly indicate that it applies only to the products covered by VM-20.
Response	The reviewers agree and adjusted the wording to make it clear that the products in scope are only those covered by VM-20.
<b>SECTION 2. DEFINITIONS</b>	
<b>Section 2.2, Asset Segmentation Plan</b>	
Comment	One commentator suggested that this definition be changed or eliminated because it is inconsistent with VM-20.
Response	The reviewers changed the definition to make it consistent with VM-20.
<b>Section 2.4, Credibility</b>	
Comment	One commentator suggested the parenthetical phrase indicating that the word “predictive” is being used in the statistical sense be removed.
Response	The reviewers note that this phrase was included so that this definition was consistent with that in ASOP No. 25, <i>Credibility Procedures</i> and, therefore, made no change.
<b>Section 2.5, Deterministic Reserves</b>	
Comment	One commentator suggested adding “in accordance with the valuation manual.”
Response	The reviewers agree that this suggestion enhanced the definition and therefore made the change.
<b>Section 2.6, Granularity</b>	
Comment	One commentator suggested removing the second sentence of the definition, which provided commentary on the characteristics of models with different levels of granularity.
Response	The reviewers agree that the comments were not appropriate in the definition and deleted the sentence.
<b>Section 2.7, Margin</b>	
Comment	One commentator suggested that the definition of “Margin” in VM-20 should be used here.
Response	The reviewers agree that the alignment of this definition with that in VM-20 was appropriate and made some changes to bring the definitions closer.
<b>Section 2.10, Modeling Cell</b>	
Comment	One commentator suggested defining the term “model cell” rather than “modeling cell.”
Response	The reviewers note that the term “modeling cell” is specifically used in VM-20 section 7.B.2 and decided that no change was appropriate.
<b>Section 2.14, Principle-Based Valuation (now 2.13)</b>	
Comment	One commentator suggested that the definition of “principle-based valuation” should be consistent with that in VM-01.
Response	The reviewers agree and changed the definition to match that in VM-01.
<b>Section 2.16, Qualified Actuary (now 2.15)</b>	
Comment	One commentator recommended removing the definition of “qualified actuary.”
Response	The reviewers believe it is appropriate to leave this definition in the standard but adjusted the wording to make the definition more like that in VM-01.

<b>Section 2.18, Risk Factor (now 2.17)</b>	
Comment	One commentator suggested removing asset return from the examples in the definition of risk factors because it was not a risk factor.
Response	The reviewers disagree and made no change.
<b>Section 2.21, Starting Assets (now 2.20)</b>	
Comment	One commentator suggested revising the definition of “starting assets” to make it more consistent with section 7.D.1. of VM-20
Response	The reviewers agree and made wording changes to align the definition.
<b>Section 2.23, Valuation Date (now 2.22)</b>	
Comment	One commentator suggested using wording consistent with the definition in VM-01.
Response	The reviewers believe that the wording in VM-01 (“Date when the reserve is to be valued”) is less clear than the “Date as of which...” in the exposure draft and, therefore, made no change in response to this comment.
<b>SECTION 3. ANALYSIS OF ISSUES AND RECOMMENDED PRACTICES</b>	
<b>Section 3.1, The Role of the Actuary (deleted)</b>	
Comment	One commentator noted that VM-20 applies to companies, yet the standard applies to actuaries.
Response	The reviewers agree and changed the scope section to incorporate the general comment that VM-20 applies to companies, whereas this standard applies to actuaries.
<b>Section 3.2, Regulatory Requirements (now 3.1)</b>	
Comment	One commentator suggested using “actuarial services,” as defined in ASOP No. 1, <i>Introductory Standard of Practice</i> , instead of the term “professional services” in this section.
Response	The reviewers agree and made the change throughout the standard.
<b>Section 3.4, Exclusion Tests (now 3.3)</b>	
Comment	One commentator suggested “economic capital measurement” instead of “internal capital measurement.”
Response	The reviewers agree and made this change in addition to the more extensive changes resulting from the responses to question 1 posed in the transmittal memorandum for the exposure draft.
<b>Section 3.5.1, Cash Flow Model (now 3.4.1(a))</b>	
Comment	One commentator objected to the use of the term “asset segmentation plan.” Two commentators felt that projections need only go so far as “material” obligations remain.
Response	The reviewers considered these comments but note that the language used is consistent with VM-20 and on that basis retained the material without change.
<b>Section 3.5.2, Model Segments (now 3.4.1(b))</b>	
Comment	One commentator suggested clarification of what is meant by “appropriate” in connection with “assignment of policies with offsetting risks to the same model segment.”
Response	The reviewers agree and added a parenthetical to clarify “appropriate” in this context.
<b>Section 3.5.3, Model Validation (now 3.4.1(c))</b>	
Comment	One commentator suggested adding guidance on the model checking procedures.
Response	The reviewers agree and added more detail to this section.
Comment	One commentator suggested that margins could disrupt validation checks.
Response	The reviewers believe that validation checks can be structured in a way to adjust for the margins and, therefore, made no change.

Comment	One commentator suggested that this section should specifically except the application of model validation procedures when no model is used, for example, if a group of policies passes the exclusion tests.
Response	The reviewers believe the section as written would not require validation of a model if no model was used and, therefore, made no change.
<b>Section 3.5.4, Asset Modeling Considerations (deleted)</b>	
Comment	Several commentators suggested that sections that unnecessarily summarize material from VM-20 be deleted.
Response	The reviewers agree and deleted this section.
<b>Section 3.6(a), Minimum Reserve and Reinsurance (now 3.5.1, Stochastic and Deterministic Reserves under Reinsurance)</b>	
Comment	Several commentators believed that it would be appropriate to strengthen and clarify the guidance with respect to reinsurance.
Response	The reviewers changed the title and made other changes to be consistent with the changes made in subsections of section 3.6 in response to comments.
<b>Section 3.6(b), Determination of a Pre-Reinsurance-Ceded Minimum Reserve (now 3.5.2, Pre-Reinsurance-Ceded Minimum Reserve)</b>	
Comment	Two commentators suggested clarifying the relation between post-reinsurance and pre-reinsurance reserves, including the selection of assets for pre-reinsurance calculations.
Response	The reviewers made extensive changes in this subsection and the following one to clarify the guidance being made with respect to pre- and post-reinsurance reserves.
<b>Section 3.6(c), Reinsurance Assumptions for Projecting Cash Flows (now 3.5.4, Recognition of Reinsurance Cash Flows in the Deterministic Reserve or Stochastic Reserve)</b>	
Comment	One commentator thought that more guidance should be given on stop-loss contracts.
Response	The reviewers clarified the guidance with respect to stochastic analysis of stop-loss reinsurance contracts and contracts with similar risks.
Comment	One commentator suggested making it clear that stochastic analysis is not mandatory in evaluating reinsurance cash flows.
Response	The reviewers agree and added language to clarify that stochastic analysis is not mandatory.
<b>Section 3.7, Assumptions (now 3.4.2)</b>	
Comment	One commentator suggested that the actuary should consider the relevance of a company's experience in establishing assumptions, rather than limit consideration to "recent experience" as suggested by the exposure draft. Additionally, the term "credible" may not have been appropriately used in this subsection.
Response	The reviewers agree and modified the language accordingly.
<b>Section 3.7.1, Mortality (now 3.4.2(a))</b>	
Comment	One commentator made several suggestions to clarify the guidance with respect to evaluating experience for the purpose of establishing appropriate mortality assumptions.
Response	The reviewers agree that the suggestions enhanced the guidance and incorporated them into this section.
<b>Section 3.7.6(b), Modifying Assumptions (now 3.4.2(f)(2), Establishing Margins)</b>	
Comment	One commentator suggested changes in the procedures for establishing margins for policyholder behavior in the absence of relevant and fully credible experience.
Response	The reviewers agree with this suggestion and modified the guidance accordingly.

Comment	One commentator questioned whether sufficient guidance is being provided with respect to evaluating which assumptions should be modeled stochastically versus evaluated using sensitivity testing or through (increasing) margins. This section was specifically identified as an area where such guidance would be helpful.
Response	The reviewers incorporated additional guidance where appropriate to address this concern; however, there was no change made in this specific section in response to the concern expressed.
<b>Section 3.7.6(d), Overall Margins (now 3.4.2 (f)(4))</b>	
Comment	One commentator suggested additional approaches to evaluating overall margins, such as looking at the conditional tail expectation implied by the prudent reserve and historical variations in experience.
Response	The reviewers agree and added these examples.
Comment	One commentator suggested that additional guidance be provided with respect to the meaning of the terms “moderately adverse” and “adequate margin.”
Response	The reviewers believe the guidance with respect to these terms is sufficient and therefore made no change.