Comment #9 – 8/25/16 – 4 p.m.

August 15, 2016

To: Life Insurance and Annuity Pricing Task Force of
the Life Committee of the Actuarial Standards Board

From: Adjani Delgado, Michael DuBois, Eric Forfa, Stuart Kwassman, Mark Pixley, and Peter Van Beaver

Subject: Comments on exposure draft on Pricing of Life Insurance and Annuity Products

Thank you for the opportunity to comment on the exposure draft on Pricing of Life Insurance and Annuity Products developed by the Life Insurance and Annuity Pricing Task Force of the Life Committee of the Actuarial Standards Board.

Section 2 Definitions

We suggest that a definition of "Assumptions" be added. One possibility based on §3.4.3 is shown below:

> Assumptions: Estimates of future factors that are out of the actuary's control (this phrase excludes non-guaranteed elements) and impact, or could impact, product performance, but are not known at the time of pricing (e.g., fully hedged benefits would not be assumptions)

Section 3 Analysis of Issues and Recommended Practices

Selecting Profitability Metrics

Discount Rates should be discussed since they can greatly influence profitability results. A possible statement could be, "Discount rates underlying profitability metrics should appropriately recognize the time value of money or the cost of capital, both on a risk-adjusted basis."

§3.2.1. The exposure draft appears to heavily endorse internal rate of return (IRR) as a profit metric. Consideration of other profit metrics should be stronger. The other profit metrics (ROA, breakeven, profit margin) tell too much of the story to allow ignoring them. If the ASB is going to "endorse" IRR, they should clarify that actuaries should consider using the modified Becker IRR and not a standard IRR.

§3.2.1b –Given its wide usage, "return on assets" should be included as an additional example.

§3.2.2: The section is too vague to provide meaningful guidance. As an example:

- What does it mean that "the actuary should consider…the expected pattern of profits over time" in selecting profitability metrics?
- "How" should the pattern of profits influence the selection of profit metrics?

It would be helpful to know this and it could be written in a non-prescriptive manner. As another example, it could suggest that IRR may not be appropriate for products with certain patterns of distributable earnings.

Add §3.2.3 Profitability Targets:

a. Level of the underlying risks (and the degree to which risk capital reflects the actual risks being taken) and the desired compensation for assuming those risks
b. Implied or explicit cost of capital
c. Any profitability targets provided by the actuary's principal
d. Discount rates
e. How to risk-adjust profit targets either through higher discount rates, higher profit targets, or higher risk capital
f. profitability targets for similar products both internal and being sold in the marketplace
g. any other considerations that the actuary determines are relevant

Developing the Model Framework

Granularity of Assumptions

The term granularity is not clear, especially with respect to some assumptions. For example, what does granularity mean for an inflation assumption? A possible alternative wording could be, "the degree to which the granularity of the assumptions corresponds to the granularity of model points and profitability metrics selected."

Accounting Bases

A potential rewording is "the degree to which the model incorporates all accounting bases that are required or expected to be used in practice";

Model Validation

- Change Model Validation to Pricing Controls
- Edit as shown—"the degree to which the **model framework** is able to support the pricing controls described in Section 3.6"

Pricing Assumptions

§3.4.2 says that "The actuary should reflect appropriate experience when setting assumptions." There might be some cases where there is no experience data to draw from, or we choose to ignore existing experience data because it's based on experience of very different products/distribution channels/etc. from the product we are developing.

§3.4.3d – We suggest modifying the statement regarding expense assumptions so that the actuary should consider whether to use fully allocated expense assumptions and/or marginal expense assumptions, as well as considering the effect of future inflation on the expense assumptions.

§3.4.3e - A potential rewording is "the principal's capacity and intent with regard to inforce management strategies, including nonguaranteed elements." Eliminates the redundant clause, "when setting assumptions"

§3.4.4 – Regarding the selection of market consistent or real world for stochastic modeling, the current phrasing is too narrow. The selection should also consider the principal's objectives. For example, some actuaries may use only market-consistent stochastic modeling in pricing, even though some product features are not be perfectly hedge-able in the observable market.

§3.5 - - A potential rewording is "The actuary should evaluate and consider the cost of risk when performing a **profitability analysis**." Eliminate either the initial "The actuary should consider the following approaches to evaluating the cost of risk" or remove its equivalent from each bullet.

§3.6.a.iii – It is unclear which duties need to be separated and it may not be possible to adhere to in smaller companies, since there may only be a single actuary performing all of these tasks.

§3.6.b.ii - - It is unclear which practices are referred to by the term 'expected practice' which could be non-guaranteed elements practices, dividend practices, reinsurance practices, coding practices, etc.

Section 4 Communications and Disclosure

§4.2 – There are two item c's so the second should be d.

A potential rewording is of the new d is "the manner in which the actuary has evaluated and considered the cost of risk as described in section 3.5 of this standard."

Questions:

1. Does the draft ASOP provide appropriate guidance to the actuary when providing actuarial services related to the pricing of life insurance and annuity products?

   Yes, it guides with a light touch and allows for documented deviation.

   a. The biggest item that may be missing is how to set a profit target.
   b. The ASOP also does not consider profitability variation from model point to model point. (e.g. the 75 year olds having a 4% IRR while the model office is priced to an 11% IRR)

2. Given the range of roles actuaries may have in the pricing of life insurance and annuity products, is the scope of the draft ASOP appropriate

   Yes

3. Does the draft ASOP address the range of products and pricing methodologies used in the industry?

   Yes, but two issues should be considered:

   a. The exposure draft heavily endorses IRR as a profit metric. The phrase "may consider" other profit metrics is too soft. Other profit metrics (ROA, breakeven, profit margin) tell too much of the story to allow ignoring them.
   b. Some mention should be made regarding the pricing of combination products (e.g., life/LTC combo products). Two options are i) pricing each component separately, or ii) price both components together in a single model.

4. Are the disclosures required in section 4 appropriate?

   The disclosures required in section 4 seem appropriate for most products that are within the scope of this ASOP. There are situations that may arise where disclosing the items listed in section 4.2 in an actuarial report would be impractical and/or hinder the company's competitiveness depending on the intended users of an actuarial report. I believe a clause should be added instructing the actuary to use actuarial judgement on whether these disclosures are necessary. For example, such a situation may arise when pricing group master contracts with individual certificates for a client (also considered a principal) other than the actuary's employer.