August 26, 2016

Pricing of Life Insurance and Annuity Products Exposure Draft
Actuarial Standards Board
1850 M Street, NW, Suite 300
Washington, DC 20036

To Actuarial Standards Board

We applaud the task force's well-thought-out efforts to develop an Actuarial Standard of Practice on the Pricing of Life Insurance and Annuity Products.

Below are our responses to the questions posed in the Exposure Draft:

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?

   The guidance is helpful but we believe it could be improved in several areas as noted below.

   Definitions (Section 2)
   "Cost of Risk" is a critical element in performing a profitability analysis (Section 3.5). However, cost of Risk can mean different things to different people and can be influenced by the specific situation. In order to reduce confusion, we believe it would be beneficial to add "Cost of Risk" to the definitions in Section 2.

   Assumption Setting (Section 3.4.3)
   Section 3.4.3.d states that the actuary should consider "expense assumptions that reflect the effects of future inflation on the expense assumptions." We believe that the actuary should consider both increases and decreases in future expenses. We propose that Section 3.4.3.d be revised to, "expense assumptions that reflect anticipated future trends in expenses (for example inflation or expense efficiencies); and"

   Section 3.4.3.e states that "…the principal's capacity and intent…" are among the elements the actuary should consider when setting assumptions. We feel this puts the actuary in a difficult position. Certainly, the actuary should use experience when setting assumptions (Section 3.4.2). The extent to which the actuary has relied on others for those assumptions should also be noted (Section 3.7). However, evaluating a principal's intent is beyond what is reasonable for a pricing actuary to certify.

   Capital Market Assumptions (Section 3.4.4)
   This section directs the actuary to "….take into account the design of the product when determining whether to use market consistent assumptions or real world assumptions." While an important consideration, this section seems misplaced.

The thoughts conveyed here should either be part of the considerations in Developing the Model Framework (Section 3.3) or an element of Assumption Setting (Section 3.4.3). We suggest that a comparison to benefits available in the capital markets be added to the investment assumption discussion in Section 3.4.3.a.

Cost of Risk (Section 3.5)
We found this section confusing. Assumption Margins (Section 3.5.1) and Risk Capital (Section 3.5.2) are two approaches for funding the cost of risk while Sensitivity Analysis (Section 3.5.3) and Stochastic Analysis (Section 3.5.4) are two techniques for evaluating that cost. Furthermore, all are listed as elements the actuary "should consider". We suggest wording which directs the actuary to consider one or more of the given approaches to fund the cost of risk. Separately, the standard can note techniques to evaluate the cost. We also note that techniques to evaluate the cost of risk are many and varied. The standard should leave open the possibility of using other techniques.

Risk Capital (Section 3.5.2)
The proposed standard directs the actuary to use a risk capital assumption that is consistent with the principal's assessment of capital. Another possibility is to do this implicitly by using a higher hurdle rate for riskier products. The standard should allow the actuary either option.

Pricing Controls (Section 3.6)
Establishing a strong control environment is critical to a robust pricing system. We suggest adding language that ensures the control environment is documented. We propose, "The actuary should establish and document controls over pricing to reasonably protect the reliability of the process and results."

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?

   In general, we believe that the scope of the proposed standard is appropriate. However, we believe that the guidance could be improved by clarifying or revising the scope with respect to group products and nonguaranteed elements.

   Group products (Section 1.2)
   We believe that the scope should include all group life and group annuity contracts, regardless of whether the contracts have individual certificates.

   Section 1.2 states that "The standard applies to life insurance and annuity products written on individual policy forms and group master contracts with individual certificates." Life insurers sell a variety of group life and group annuity products; some of these products have individual certificates, while others do not. We believe that the guidance in the standard is applicable to all group products, regardless of whether or not the product includes an individual certificate.

   Therefore, we recommend that the Board remove the reference to individual certificates, and apply the standard to all group life and group annuity products.

Nonguaranteed elements (Section 1.2)
We believe clarification is needed with respect to the determination of nonguaranteed elements.

According to Section 1.2, "This standard does not apply to actuaries when performing professional services with respect to illustrations of nonguaranteed charges or benefits subject to ASOP No. 24, *Compliance with the NAIC Life Insurance Illustrations Model Regulation.*"

In addition to the above, we believe the scope section should clarify that the standard does not apply to actuaries when performing professional services with respect to the determination or redetermination of nonguaranteed charges or benefits, as these activities are subject to ASOP No. 2, *Nonguaranteed Charges or Benefits for Life Insurance Policies and Annuity Contracts.*

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

   We recommend that the Board revise section 3.2 ("Selecting Profitability Metrics") to better reflect the methodologies that are commonly used in the industry.

Profit metrics (Section 3.2.1)
Section 3.2.1 states that "The actuary should consider using more than one profitability metric when evaluating the expected profitability." We recommend that the Board change this sentence to say "may consider" rather than "should consider". We acknowledge that there are many situations where it may be helpful to use multiple profit metrics; however, we believe that there are also situations where the use of a single profit metric is sufficient.

In addition, we note that section 3.2.1 places greater emphasis on internal rate of return (IRR) than on other profit measures. The first paragraph of 3.2.1 states that "The actuary should consider using a profitability metric that measures the expected return on initial invested capital (often referred to as an internal rate of return)" (emphasis added). Section 3.2.2 then provides a list of additional metrics that "the actuary may consider using" (emphasis added). Based on the more prominent placement of IRR in the first paragraph and the differences in wording ("should consider" for IRR, vs. "may consider" for the other metrics), the reader may conclude that IRR is the preferred profit metric.

We acknowledge that IRR is a commonly used profit metric, and that it is appropriate in many situations; however, there may be situations where IRR is not an appropriate or meaningful profit metric (e.g. when pricing products that don't generate a significant first-year loss). Therefore, we recommend that the Board revise section 3.2.1 to place IRR on equal footing with the other profit metrics. Rather than specifically mentioning IRR in the first paragraph, we recommend that the Board simply include IRR in the list of profit metrics that the actuary may consider.

Considerations in Selecting Profitability Metrics (Section 3.2.2)
In addition to the considerations that are currently included in 3.2.2, we recommend that the Board consider adding two more items:

- the principal's primary accounting basis; and
- the product's expected pattern of capital usage

4. Are the disclosures required in section 4 appropriate?

   All standards should reference ASOP #41 (*Actuarial Communications*) when directing actuaries on appropriate communication and disclosures. We agree with the reference to ASOP #41 in the initial sentence of Section 4.1; however, repeating specific sections of ASOP #41 in Sections 4.1.a, 4.1.b and 4.1.c is unnecessary and in some ways counterproductive.

We appreciate the opportunity to comment on the exposure draft for the proposed ASOP on the Pricing of Life Insurance and Annuity Products and look forward to the eventual adoption as a standard of practice for actuaries.

Sincerely,

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