AMERICAN ACADEMY of ACTUARIES

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May 31, 2017

Principle-Based Reserves for Life Products
Actuarial Standards Board
1850 M Street, NW
Suite 300
Washington, DC 20036

Re: Comments on the ASOP Exposure Draft, *Principle-Based Reserves for Life Products* (March 2017)

To Whom It May Concern:

On behalf of the PBR Governance Work Group of the American Academy of Actuaries,[1] I appreciate the opportunity to provide comments on the March 2017 exposure draft for a proposed actuarial standard of practice (ASOP), *Principle-Based Reserves for Life Products*.

Overall, we believe the changes from the first exposure draft represent considerable improvement.

In particular, you have requested comment on the following:

1. **Is the guidance concerning VM-G clear and appropriate (section 3.1)?**

   The VM-G guidance in the ASOP provides no indication to the reader that the outlined VM-G responsibilities apply beyond life insurance products. Although it is clear that this ASOP is intended to focus on life products, it may still be beneficial for actuaries to note that VM-G also applies to VM-21 (Actuarial Guideline 43).

   Therefore, if it does not distract from the ASOP scope, we recommend adding a comment that VM-G applies to variable annuities with guarantees and is also intended to cover future principle-based reserving calculations on other products as such guidance emerges.

[1] The American Academy of Actuaries is a 19,000- member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

2. **Is the guidance concerning the PBR Actuarial Report clear and appropriate (section 4.2)?**

   The section 4.2 reference to the verification in section 3.7 is not clear. Is section 4.2 referring to "responsibility for the verification that the methods, models, assumptions, documented internal standards, and documented internal controls for a group of policies appropriately reflect the requirements of the Valuation Manual"? It may be clearer to repeat this wording in section 4.2 and append with "(as referred to in section 3.7 of this ASOP)".

3. **Are there any significant inconsistencies between the requirements of this draft ASOP and the requirements of the Valuation Manual?**

   In general, the 2017 PBR ASOP exposure draft is in line with the Valuation Manual; however, improvements could be made to increase consistency between the two in the following areas:

   - Implicit Margin Distinction – Toward the end of section 3.4.2.a of the ASOP, it states that "mortality improvement beyond the valuation date in the estimates of the impact of individual and aggregate margins." We would recommend labeling such mortality improvement as an implicit margin to differentiate it from an explicit margin. When it comes to where this is documented in the VM-31 report, there is a notable distinction between the two.

   - Shareholder Dividends – Section 3.4.1 states "According to section 9 of VM-20, costs that are not specific to the insurance contract (for example, federal income taxes, shareholder dividends, and costs related to operational failures, mismanagement, fraud, and regulatory risks) are not recognized in the reserve calculation."

     There could be confusion between the references to "shareholder dividends" and "policyholder dividends" (which could be included as a non-guaranteed element in the reserve). And while "shareholder dividends" may not be recognized as a liability cash flow, it could be considered for equity-type assets (such limited partnerships) for the development of deterministic reserve net asset earned rate.

   - Premium Pattern Sensitivities – Section 3.4.2.c.2 describes in detail the various premium patterns that may be considered when setting assumptions for flexible premium products. It may be worthwhile to reference the required sensitivity testing of applicable premium patterns defined in VM-31 5.i under Policyholder Behavior in this section.

   - Overall Margin – At the bottom of Section 3.4.2.f.2, it may be worthwhile to reference VM-31 12.a-b. This section of VM-31 discusses requirements of the individual and aggregate margin impacts on the deterministic reserve in the PBR Actuarial Report.

- Title – Because the draft ASOP focuses on PBR for life insurance products under VM-20, it may be worthwhile to consider indicating this in the title by changing it to “Principle-Based Reserves for Life Products under VM-20.”

- Key Changes – The Key Changes section on page vi only mentions updates to reflect amendments to VM-G. It may be worthwhile to consider if any of the other recent valuation manual amendments reflected in this draft ASOP should also be listed under Key Changes.

- VM Amendments – The exposure draft section on page v refers to APFs on post-level term profits and aggregating across product lines. However, there is not much content in the draft ASOP on these amendments, nor the amendments on the companywide exemption. It may be worthwhile to consider whether these APFs warrant any additional content in the ASOP.

- VM-20 2.G – Various individual simplifications, approximations, and model efficiency techniques are mentioned in a few places throughout the draft ASOP. It may be worthwhile to generally address ASOPs surrounding simplifications, approximations, and model efficiency techniques as allowed under VM-20 Section 2.G. One example is the discussion in Section 3.4.1.d.1 of considerations when grouping or compressing liability cells.

- Stochastic Exclusion Test – Section 3.3.2 discusses actuarial certification for the stochastic exclusion test. It may be worthwhile to mention or have another section discussing actuarial demonstration for the stochastic exclusion test.

- Wording – There are two instances in the ASOP, one in Section 1 and one in Section 2, that refer to “Chapter VM-20” and “Chapter VM-31” respectively. To be consistent with the VM and the rest of the ASOP, it may be worthwhile to consider using “Section” instead of “Chapter.”

- Standard Valuation Law – The definition of PBR in Section 2.13 refers to “section 12 of the Standard Valuation Law as specified in the Valuation Manual.” It may be worthwhile to consider informing readers that the Standard Valuation Law is located in Section VM-05 of the Valuation Manual.

4. **Does the proposed effective date of December 31, 2017 provide sufficient time to comply with this standard if the ASB adopts the standard in September 2017?**

   Yes, the effective date of Dec. 31, 2017 should provide sufficient time to comply with the ASOP. There have already been multiple drafts released to the actuarial community, and the latest version does not seem to have significant modifications that the insurer would not already being following if planning to implement PBR for year-end 2017.

In terms of more general comments, the PBR Governance Work Group does have significant concerns about the level of duplication and restatement of valuation manual wording within the draft PBR ASOP. Although this may limit the need for the reader to refer to the Valuation Manual, it could also lead to inconsistencies and challenges updating the ASOP when the Valuation Manual changes. In addition, it could make it difficult for readers to distinguish ASOPs from valuation manual requirements. To better elucidate the new guidance set forth in the document, it may be worthwhile to consider removing non-essential Valuation Manual restatements from the standard, or replacing them with a simple reference to the Valuation Manual when sufficient. Also, the first paragraph of Section 3.1 of the standard states that "An actuary performing actuarial services within the scope of this standard should be familiar with applicable law and regulation including the Standard Valuation Law and the Valuation Manual." It may be worthwhile to consider adding the following sentence to the end of Section 1.3 on Cross References: "Actuaries unfamiliar with any of the Valuation Manual references made within this standard should refer the Valuation Manual for additional details."

The following are examples of sections in the standard that could be considered to include non-essential restatements of the Valuation Manual:

- Section 3.3.1 on Grouping
    - The section begins as follows: "In constructing groups of contracts for the purposes of applying the stochastic exclusion ratio test and the deterministic exclusion test, the company may not group together contract types with significantly different risk profiles. In evaluating a group of contracts against this criterion, the actuary should consider the following …"
        - It may be worthwhile to consider the following language instead: "In evaluating the risk profiles of policy groupings, the actuary should consider the following …"

- Section 3.3.2 on Certification
    - The section begins as follows: "In some cases, the stochastic exclusion test may be satisfied by providing a certification by a qualified actuary that a group of policies is not subject to material interest rate risk or asset return volatility risk in accordance with section 6 of VM-20. When providing such a certification, the actuary should consider the significance of the impact on reserves of recognizing the interest rate or asset return volatility risks in the reserve calculations. Examples of the types of methods that could be used to support such a certification are provided in the guidance note of section 6 of VM-20. In applying these or any other method, the actuary should consider the possible impact on reserves of factors such as the following …"
        - It may be worthwhile to consider the following language instead: "In certifying that a group of policies is not subject to material interest rate risk or asset return volatility risk, the actuary should consider the significance of the impact on reserves, and the possible impact on reserves of factors such as the following …"

- Section 3.4.1.a on Cash Flow Models
  - This section simply restates VM-21 7.A.1. It may be worthwhile to consider eliminating this section if no new guidance applies.

- Section 3.4.1.d on Liability Modeling Considerations
  - Subsection 1 on modeling cells begins as follows: "The actuary may group policies with similar risk profiles in representative modeling cells. When grouping is used, the actuary should demonstrate that the use of a model with a higher degree of granularity is unlikely to result in a materially higher minimum reserve. Acceptable demonstrations for this purpose include, but are not limited to, the following …"
    - It may be worthwhile to consider the following language instead: "To show that any model cell compression used in the calculation of modeled reserves meets the requirements of VM-20 Section 2.G, acceptable demonstrations include, but are not limited to, the following …"
  - Subsection 2 does not appear to provide anything beyond what is already in VM-20 and VM-31. In fact, the examples and guidance in the draft ASOP may be weaker than the Valuation Manual because only a few of the relevant requirements from the Valuation Manual are considered within the examples in the draft ASOP. The first example on credited rates considers only a few of the relevant requirements from VM-20 7.C and VM-31. The last example on adjusting lapse rates for lag in the credited rate is implicit in VM-20 7.C and VM-31 D.9. It may be worthwhile to consider eliminating this section if no new guidance applies.

- Section 3.4.1.e on Use of Prior Period Data
  - It may be worthwhile to consider eliminating the first two paragraphs of this section, which appear to simply paraphrase VM-31 D.11.g, but leave the remainder of the section that relates new guidance relevant to the use of prior period data.

- Section 3.4.2 on Assumptions
  - It may be worthwhile to consider eliminating the first two sentences from the third paragraph, which restate requirements contained in VM-20 9.A.7, and instead start the section with the third sentence which begins "The actuary should consider the level of granularity …"

- Sections 3.4.2.a on Mortality, 3.4.2.c on Policyholder Behavior, 3.4.2.d on Expenses, 3.4.2.f on Determining Assumption Margins, and 3.5 on Reinsurance.
  - These sections are rather lengthy and paraphrase the Valuation Manual significantly. It is difficult to tell what represents new guidance versus what represents a restatement of requirements already in the Valuation Manual. It may be worthwhile to consider eliminating or minimizing restatements to better elucidate new guidance.

- Section 3.4.2.b on Investment Experience

- Subsection 1 doesn't appear to include any new guidance. The subsection also lists only a subset of the requirements from VM-20 2.G when discussing the use of scenario reduction techniques. It may be worthwhile to consider eliminating this subsection.
- Subsection 2 appears to paraphrase requirements from VM-20 7.E.1.a in its first three sentences. It may be worthwhile to consider eliminating these first three sentences, but leave the fourth and final sentence in the subsection, which include applicable guidance related to the modeling the rebalancing associated with duration matching investment strategies.

- Section 3.4.2.e on Taxes
  - This section appears to simply restate the Valuation Manual requirements regarding taxes, with no mention of any newly relevant guidance. It may be worthwhile to consider eliminating this section.

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We thank you for your work on this proposed ASOP and for the opportunity to provide the comments above. If you have any questions or would like to discuss any of these comments further, please contact Heather Jerbi, the Academy's assistant director of public policy, at 202.785.7869 or jerbi@actuary.org.

Sincerely,

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Chairperson, PBR Governance Work Group
American Academy of Actuaries