

Comment #6 – 5/30/17 – 6:03 p.m.

May 30, 2017

Linda M. Lankowski, Chairperson
Task Force on Principle-Based Reserves

Actuarial Standards Board
1850 M St., Suite 300
Washington, DC 20036-5805

Via email: comments@actuary.org

Re: Proposed Actuarial Standard of Practice (ASOP), Principle-Based Reserves (PBR) for Life Products

Dear Ms. Lankowski,

Thank you for the opportunity to provide comment on the proposed ASOP for Life PBR.

The NAIC adoption of PBR has introduced a new method for calculating life insurance policy reserves, replacing a formulaic approach with a more principle-based framework. This framework requires substantial actuarial judgment, modeling, and analysis, so we understand why the Actuarial Standards Board would consider the need for an ASOP to help guide actuaries as they implement PBR for life products.

Although VM-20 reflects a significant shift in the minimum statutory reserve calculation for life insurance policies, PBR is based on principles that are foundational and familiar to the actuarial profession: stochastic modeling/calculation of conditional tail expectation (CTE), deterministic modeling, asset and liability modeling, cash flow testing, assumption setting, and setting margins.

Because of this, there are a number of ASOPs that already apply to the application of PBR to life insurance:

- 2: Nonguaranteed Charges or Benefits for Life Insurance Policies and Annuity Contracts
- 7: Analysis of Life, Health, or Property/Casualty Insurer Cash Flows
- 23: Data Quality
- 25: Credibility Procedures
- 41: Actuarial Communications
- Draft: Setting Assumptions
- Draft: Modeling

The few unique components of VM-20 are relatively prescriptive, and their description in VM-20 is comprehensive, so we believe an ASOP dedicated to PBR for life is redundant and therefore unnecessary. We note that the guidance in the existing ASOPs has generally been sufficient for PBR for variable annuities since the 12/31/2009 effective date, and new ASOP drafts are under development for the limited areas where additional guidance is needed. If there is a desire to pull these components together into one comprehensive ASOP, perhaps a general PBR ASOP would be more appropriate rather than one specific to each product type.

If the Actuarial Standards Board chooses to continue development of an ASOP for Life PBR, we have a number of concerns with the pending draft. The length and format make the ASOP difficult to reference and use, and there is a substantial amount of duplication from VM-20 in the ASOP. These redundancies may cause conflicts if VM-20 is updated regularly, and the restatement of the Valuation Manual and other ASOPs indicates that the existing guidance is sufficient and an ASOP for life PBR is not necessary.

Our responses to the specific inquiries follow:

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

The first paragraph in Section 3.1 is clear and appropriate. The second paragraph in Section 3.1 is a restatement of VM-G and therefore is unnecessary and should be deleted. The third paragraph in Section 3.1 would be more appropriate in draft ASOP Section 1.2 (scope) and should be merged with 1.2.

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

The first paragraph in Section 4.2, including parts a. and b., is a restatement of VM-31 (with some differences) and therefore is unnecessary and should be deleted. The last two paragraphs in Section 4.2 are clear and appropriate.

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

The length and format of the draft ASOP make it difficult to use and compare against the Valuation Manual. Some language is identical, some language is identical but the draft ASOP omits parts of the Valuation Manual, and some language could be interpreted as contradictory to the Valuation Manual. In our review, we identified a number of inconsistencies between the draft ASOP and the Valuation Manual. We have included examples of some of the inconsistencies we found below, and note that an exhaustive comparison would require significantly more time and resources.

- Materiality is a clear consideration throughout VM-20, but the draft ASOP often omits reference to materiality when listing considerations for the actuary
- Draft ASOP Section 3.4.1.a (cash flow model specifications) omits reference to VM-20 Section 7.A.2 (allowable model simplifications or efficiency techniques)
- Policyholder behavior data referenced in draft ASOP Section 3.4.1.e item 3 (use of prior period data) is omitted from the three-month limitation in VM-20 Section 2.E, and often would not be sufficiently credible to consider updates to a company's best estimate assumptions
- Draft ASOP Section 3.4.2.a (mortality assumptions) states mortality trends beyond the valuation date should be used in setting assumptions if the trend will increase reserves, while VM-20 Section 9.C.2.g does not permit mortality improvement beyond the valuation date under any circumstances
- Draft ASOP Section 3.4.2.c (policyholder behavior assumptions) could be interpreted to recommend dynamic assumptions beyond what is required in VM-20 Section 9, and beyond what may be appropriate or feasible; we prefer the more refined list in the Practice Note developed by the American Academy of Actuaries ("Life Principle-Based Reserves Under VM-20")

Future revisions to the Valuation Manual may create additional inconsistencies if the Actuarial Standards Board does not intend to continuously maintain this ASOP. With so many specific references to detailed language within VM-20, we would be concerned having a potentially significant number of conflicting statements in this ASOP, and believe the likelihood of inconsistencies is high given the current ongoing evolution 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?

As noted above, we do not believe there is a need for an ASOP dedicated to Life PBR, since the ASOPs that already apply to the application of PBR to life insurance are sufficient (or are currently in development).

Thank you for your consideration of these comments. Since we have concluded that an ASOP dedicated to Life PBR is not necessary, we have refrained from compiling a comprehensive list of comments on the specific content of the draft. We hope our input has been helpful and would be happy to discuss in further detail.

Sincerely,

Laura Hanson, ASA, MAAA

Michael McCarty, FSA, MAAA