

Comment #5 – 10/30/17 – 4:47 p.m.

October 31, 2017

Pricing of Life Insurance and Annuity Products Exposure Draft
Actuarial Standards Board
1850 M St., Suite 300
Washington, DC 20036-5805

We are pleased to submit these comments about the exposure draft. The opinions contained in this document are our own and do not necessarily represent the opinions of Prudential Financial or its employees.

There were three questions the ASOP taskforce specifically wished us to consider. We will briefly answer these questions, and follow with comments regarding particular sections of the exposure draft.

1. Is it clear what actuarial services are covered in section 1.2, Scope? If not, please give an example of an actuarial service or a product whose exclusion is unclear and how to clarify.

Yes, it is clear. We provided minor suggestions to improve this section.

2. Throughout the ASOP, there are references to “the criteria of the actuary’s principal.” Are the examples in section 3.1.1, Criteria of the Actuary’s Principal, adequate to apply the guidance included in the draft ASOP?

We believe the examples are adequate.

3. Is the guidance in section 3.6, Governance and Controls, clear?

We have some suggestions to improve this section.

Comments:

1.2 Scope

Following this sentence:

“The standard also applies to group master contracts with individual certificates that are priced in a similar manner to products written on individual life and annuity policy forms.”

we would like to add the following language:

“To the extent that a product does not obviously fall into the scope described, the actuary should use their own judgement to determine whether the product is in scope.”

Rationale: Actuaries in the U.S. may be pricing products for non-U.S. markets. where the product regulations and structures can be quite different than in the U.S. The drafted scope is defined based on U.S. product classifications and regulations. In some non-U.S. markets, the difference between individual and group products is not as well defined as in the U.S.

Section 3.1.1 Criteria of the Actuary’s Principal

We would like clarification about “risk management policies” in 3.1.1.c. Concrete examples of risk management policies such as target capital, sensitivity analyses, etc. would be helpful.

Section 3.3 Developing the Model

Proposed change (1):

We recommend updating the language at the beginning of this section to include the scenario of the actuary as the user of the model but not the developer:

“The actuary should develop the model to support **pricing** in a manner consistent with the criteria of the actuary’s principal. The actuary should develop a model that accommodates the design of the product and the selected **profitability metrics**, and reasonably simulates the future financial impact of the product.”

Rationale: The actuary might use a pricing model developed by an external consulting firm or modeling team. We agree that all the items in the list are still appropriate for the pricing model user.

Proposed change (2):

We would like clarification about “Accounting and Actuarial Bases” in 3.3.f.

Rationale: The word “Bases” here is not clear. Adding definition or examples of what “Bases” refers to would be helpful.

Proposed change (3):

Change

“the degree to which the model uses an appropriate method to quantify risks as described

in section 3.5”
to
“the degree to which the model uses an appropriate method as described in section 3.5 to quantify risks.”

Rationale: section 3.5 describes risk quantification methods.

Section 3.4.3 Consistency of Assumptions

Proposed change (1):
We would like clarification regarding “internally consistent with other components of the model.”

Rationale: The language “other components of the model” is not clear. Does this refer to other assumptions or other products?

Proposed change (2):

We suggest adding:
“The actuary should consider the interaction of different assumptions, e.g. how economic conditions impact policyholder’s lapse behavior, and/or how a mortality assumption interacts with other product assumptions such as lapse or morbidity.”

Rationale: We believe interaction of different assumptions should be considered.

Proposed change (3):

Change:

“consistent with assumptions used for other assignments within the entity”

To:

“consistent with assumptions used for other intended uses such as GAAP valuation or Asset Adequacy Testing within the entity.”

Rationale: “assignments” here sounds very broad. We suggest updating the language to be more specific.

Section 3.4.4 Product Design and Assumption Setting

Proposed change (1):
We would like clarification about “classification of future applicants” in 3.4.4.c.

Rationale: The language “classification of future applicants” is not clear. Does this refer to a different underwriting class?

Proposed change (2):

We would like to add “population characteristics” to mortality and morbidity assumptions consideration in 3.4.4.c.

Rationale: We believe population characteristics/demographic factors should be considered to set mortality and morbidity assumptions.

Proposed change (3):

Change:

“the principal’s capacity and intent with regard to enforce management strategies, including dividends and nonguaranteed elements.” in 3.4.4.g

to:

“the principal’s capacity and intent with regard to enforce management strategies, including dividends and nonguaranteed elements, if those features exist in the product.”

Rationale: We believe the first step is to decide the existence of dividends and nonguaranteed elements before the principal’s capacity and intent can be considered.

Section 3.4.5 Product Design and Assumption Setting

Proposed change:

Change:

“to assure that it aligns with the profitability goals and risk management policy of the actuary’s principal”

to:

“to assess how well it aligns with the profitability goals and risk management policy of the actuary’s principal.”

Rationale: We believe comparing the cost using market consistent assumptions is for reference purposes, not to assure the alignment with profitability goals and risk management policy.

Section 3.5.1 Cost of Capital

Proposed change:

We would like to add clarification about “Cost of Capital.”

Rationale: Cost of Capital could be the hurdle rate, which is the estimated minimum required rate given the level of risk, and it is usually determined by a company’s Treasurers department. Cost of Capital in the drafted guidance also sounds like the required capital amount. We suggest the language be improved to be more specific.

Section 3.6 Governance and Controls

Proposed change (1):

Change:

“Examples of governance and controls include, but are not limited to, the following:”

to:

“Examples of governance and controls may include the following:”

Rationale: This will reduce the potential confusion that the Actuary should meet the requirements of the entire list.

Proposed change (2):

Change:

“validation that the model reasonably simulates the product’s expected impact on the company’s future financial and risk position;”

to:

“validation that the model reasonably simulates the future financial impact of the product;”

Rationale: In practice, pricing is done on a standalone product basis, rather than on a portfolio basis. The process of considering the impact on the company’s financials and risk profile can be part of the forecasting and Enterprise Risk Management process rather than a pricing exercise.

Proposed change (3):

Change:

“The actuary should consider documenting the governance and controls used as part of **pricing.**”

to:

“The actuary should assure that the governance and controls used as part of **pricing** are appropriately documented.”

Rationale: Documenting the governance and controls in pricing is a reasonable requirement. “Should consider” would mean the actuary could have a reason for not documenting the governance and controls. We cannot think of a good reason for doing this.

We appreciate the opportunity to submit comments on this exposure draft.

Sincerely,

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