Comment #7 – 12/18/17 – 10:15 p.m.

I have concerns with the section 3.4.5 Capital Market Assumptions in the June 2017 exposure draft of the Life and Annuity Pricing ASOP. I have missed the formal deadline so I hope this feedback will find an audience. With the hopes there may still be opportunity to provide feedback, I have summarized my concerns below.

The section reads:

"If performing stochastic analysis, the actuary should take into account the design of the product when determining whether to use market consistent assumptions or real-world assumptions. When analyzing a benefit that can be replicated using liquid capital market instruments the actuary should consider the cost of the benefit using market consistent assumptions to the price of a comparable investment guarantee observed in capital markets to assure that it aligns with the profitability goals and risk management policy of the actuary's principal."

As any cashflow can be replicated using market instruments this provision may be more imposing on fixed or indexed annuity pricing then intended. It seems to be instructing actuaries to price using market consistent scenarios as that will "assures alignment" with the profit goal and risk management policy, which implies alignment is true for all companies. I think that is not necessarily true. I see the intent of 3.4.5 as instructing actuaries to make a careful choice between the two types of economic scenarios to be aligned… not that using market consistent assumptions alone *will assure alignment* as it reads today. What if the goal is real world based, how can pricing using market consistent scenarios assure alignment?

I think when to use one set of scenarios over the other is a bit out of scope, better in acceptable practices than the ASOP. I question whether it is redundant with 3.3 e. and the section 3.4.3 consistency of assumptions "consistent with company practices and other assignments" implicitly covers this. In which I think you can drop the section. I have seen that someone suggested the deletion in the first exposure draft and the review group did not react that way, so there may be something still needed in the ASOP in section 3.4, that I address below.

Another intent, based on the words "When analyzing a benefit that can be replicated using liquid capital market instruments the actuary should consider the cost of the benefit using market consistent assumptions to the price of a comparable investment guarantee observed in capital markets" resonates more with me. Only I am not sure what is meant by "replicated with liquid capital market instruments"

Should we price fixed interest annuities with a risk-free instrument, 100% interest rate swaptions and a credit derivative swap, over bonds and mortgages and the more limited interest hedging instruments a carrier will more typical invest in. In which case is 3.4.5 saying actuarial staff needs to gather competitive quotes for all those instruments even knowing the company will not invest in that manner?

I could get behind language in 3.4.5 such as "The actuary should take into account the design of the product and consistency with the profitability goals and risk management policy of the actuary's principal when determining when and where to use market consistent assumptionsg" And perhaps the added note

“Such consideration is of particular importance for the actuary to consider when the product design or benefit features can easily be replicated with or will be hedged with capital market instruments.”

Note, that in my re-wording I have dropped the lead-in “if performing stochastic analysis” as I am a strong believer in a real-world pricing exercise that hedging assets are modelled at capital market cost… not necessarily equal to benefits the hedging activity provides in the real- world scenario, as Wall street needs to profit too I expect the benefits to be less. That asset premium in the hedge cost should be reflected in deterministic pricing too.

I may be reached should you need more clarity regarding my concerns and comments at my email

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Sincerely,

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