

Comment #6 – 7/12/19 – 3:22 p.m.

July 12, 2019

Dear Actuarial Standards Board,

I would like to submit my comment on the exposure draft of the proposed revision of ASOP No. 2 “Nonguaranteed Elements for Life Insurance and Annuity Products”. The new exposure draft is a very timely update of the ASOP and offers very valuable guidance and advices for setting the NGE of life and annuity products, especially in light of the recent changes and developments in the industry. I appreciate all the effort of the ASB Task Force in developing the draft. However, I do not agree that Section 3.2.b, “NGEs for in-force products are not revised with the objective of recouping past losses or distributing past gains”, should be applied to the determination of credited interest rates for deferred annuities and other account-value based accumulation insurance products for the following reasons.

First, determining credited interest rates of deferred annuities is highly influenced by the investment performance of the assets supporting the business. Unlike mortality experience, asset performance are driven by many market factors, such as interest rates, asset defaults and credit spreads. The changes of these market factors often follow with business cycles, whose timing and severity are very hard to predict. Therefore, it is a very common practice for insurance companies to set their credited interest rates by taking both backward and forward looking views on their asset performance. As a matter of fact, the current U.S. statutory accounting guidance requires life insurance companies to capitalize any realized capital gains and losses resulting from the changes in the general level of interest rates through interest maintenance reserves and amortize them into the future investment income over the expected life of the assets that are sold. In this case, the future investment income are actually affected by the realized gains and losses in the past. It would be contradictory to allow companies to set credited interest rates based on the future investment income, but at the same time prohibit them from reflecting the impacts of the gains or losses realized in the past in their future credited interest rates.

Secondly, I would like to point out that the difference between the saving nature of deferred annuities or other accumulation insurance products and the protective nature of life or health insurance products warrants a different treatment of managing credited interest rates as oppose to managing COIs. One objective of offering and managing the non-guaranteed credited interest rates of these products is to share the investment performance of the underlying assets supporting the business to policyholders over time, subject to the contractual guarantees of the products. The non-guaranteed credited interest rates according to some policy forms allow companies to offer more attractive investment returns to policyholders with proportional increases in sharing of risks. This can be illustrated by comparing how performance and risk is shared with a variable deferred annuity against a multi-year guarantee fixed deferred annuity. It is indeed beneficial for consumers to have this wide spectrum of products in the market, so that they can choose the suitable products based on their particular needs and risk appetites. This allows insurance companies to offer products across a range of competitiveness and risk sharing and manage the risks associated with investment and credited rates more efficiently. The flexibility also

allows companies to take a longer term view in setting their credited interest rates where the policy forms allow, which will help achieve more stable credited interest rates over time. As we mentioned early, market factors that influence investment performance are very complicated and difficult to predict. If we limit insurance companies only to take a forward-looking view in setting their non-guaranteed credited interest rates, we may potentially force them to take an overly conservative view of future investment performance or over-react to short-term market volatility in their rate setting process, which would be opposite to the objectives of the ASOP.

For the two reasons above, I suggest excluding managing the non-guaranteed credited interest rates of deferred annuity or other accumulation life insurance products from the scope of Section 3.2.b. I understand the needs to prevent insurance companies from abusing non-guaranteed elements and improperly passing losses to consumers. But I think this goal could be better achieved through other means, such as properly segregating underlying investment portfolios supporting the business, and clearly defining which gains and losses can be passed to which group of policyholders, as oppose to limiting insurance companies to only taking forward looking view in setting their non-guaranteed credited interest rates. The latter approach could potentially lead to a less efficient credited interest rate setting process and the unintended consequences as mentioned above.

I would like to note my comments above only represent my personal view as a Member of American Academy of Actuaries, and do not necessarily represent the view of Reinsurance Group of America, which I am working for. I have been designing and pricing reinsurance transactions for life and annuity products for over 10 years at RGA, and will very appreciate your consideration of my comments. Please let me know if you have any questions. Thank you very much.

Sincerely,

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