

12 July 2019

ASOP No. 2 Revision
Actuarial Standards Board
1850 M Street, NW, Suite 300
Washington, DC 20036-5805
comments@actuary.org

Re: ASOP 2 Exposure Draft

Dear ASB and, in particular, the Task Force to Revise ASOP 2:

We greatly appreciate the opportunity to provide comments on the recent ASOP 2 Exposure Draft exposed by the ASB on March 2019. While we recognize the extensive efforts taken by the ASB in revising ASOP 2, we have concerns about the Exposure Draft, set forth below. These comments are provided by the undersigned as individual practicing actuaries on our own behalf.

As a fundamental matter, nonguaranteed elements (NGEs) are nonguaranteed to allow the insurer to exercise the discretion allowed by the policy form, applicable law and regulation, and general principles of equitable treatment and sound actuarial practice in the determination of NGEs. Upon a first reading, the extensive changes and detailed language in the ASOP 2 Exposure Draft seem to be inconsistent with the purpose of ASOPs as described in ASOP 1, sections 3.1.3 through 3.1.6. Much of the new language seems to be prescriptive and removes or reduces the expected and necessary need for both the actuary's professional judgement and the insurer's discretion in setting NGEs. Although multiple re-readings alleviated some of these concerns, we believe the Exposure Draft may be improved upon as noted in the remainder of this comment letter.

2.1 Anticipated Experience Factor – Consider including required capital in the examples of **anticipated experience factors**. Similar to the level of expense, the level of required capital may increase or decrease over time due to, among other things, regulatory changes, competitive pressures or changes in an insurer's risk profile.

2.2 Determination Policy – We believe it is appropriate to include in the insurer's determination policy the insurer's position on how to accommodate illustration requirements when developing NGEs. Adding such language here would eliminate the need for the orphan sentence in section 3.4: "The actuary should also take into account illustration requirements when determining **NGE scales**." Consider language such as "For example, the **determination policy** could include the insurer's governing principles and requirements, profitability requirements, capital requirements, guidelines for drafting product provisions, **principles on addressing illustration requirements**, and requirements for and frequency of reviews of **NGEs** on in-force products."

2.6 Policy – Some of us found the current wording to be confusing. We offer the following two alternative wordings for your consideration.

“An individual life insurance **policy, an individual** ~~or~~ annuity contract, or a group certificate that operates in substantially the same manner as an individual life insurance **policy** or an individual annuity contract with respect to **NGEs.**”

“An individual life insurance **policy** or annuity contract. **Also,** ~~or~~ a group life insurance or annuity certificate with **NGEs** that operates in substantially the same manner as an individual life insurance **policy** or an individual annuity contract with respect to the **NGEs.**”

3.2 – Consider striking the following language as unnecessary and overly prescriptive.

~~“The actuary should provide guidance on developing, modifying, or applying the determination policy that is consistent with the following:~~

- ~~a. NGEs for in-force products are revised only if the anticipated experience factors have changed since issue or since the previous revision; and~~
- ~~b. NGEs for in-force products are not revised with the objective of recouping past losses or distributing past gains.”~~

If the Task Force feels that there is a compelling need for such language, then we respectfully suggest modifying it in a manner consistent with the suggestion below.

Suggested Revision to 3.2(a)

“The actuary should provide guidance on developing, modifying, or applying the determination policy that is consistent with the following:

- a. NGEs for in-force products are revised only if **the** anticipated experience factors have changed since issue or since the previous revision; and
- b. NGEs for in-force products are not revised with the objective of recouping past losses or distributing past gains **arising from unexpected experience variations.**”

The above suggested change to 3.2(a) is intended to eliminate the perception that each NGE may have only one associated experience factor (versus multiple associated experience factors). The change in 3.2(b) is meant to more clearly allow appropriate updates to NGEs on common product designs where: (i) acquisition expenses may be recouped from future expense or cost of insurance (COI) charges or interest margins; and, (ii) where persistency credits or bonuses may distribute past gains from front-end loads. We believe that the language in 3.2(b) would be more appropriate in a regulation limiting an insurer’s discretion and is, we think, already codified in insurance law and regulation in many states. Since the actuary’s recommendations and insurer’s discretion are already constrained by insurance law and regulation, it seems unnecessary and duplicative to include this language in an ASOP.

3.3 Establishment of or Changes to Policy Classes – The guidance in this section seems more appropriate for inclusion in Practice Notes rather than in an ASOP. The detailed guidance is more of a check list of possible considerations than general principles. If the ASB decides to retain this guidance in the ASOP, we suggest considering the following comment and suggestion.

3.3.1 – The last sentence of this section as written seems to be unduly prescriptive and may inappropriately limit the actuary’s exercise of professional judgement to determine the most relevant characteristics of policy classes for the products and NGEs under review. Consider modifying the last sentence to clarify that the list is not exclusive.

Suggested Revision to 3.3.1

“When recommending **policy classes**, the actuary should take into account the **policy** provisions, the structure of **guaranteed policy factors** and **NGEs**, the time period over which **policies** are issued (for example, **policies** issued before or after a particular date could be in distinct **policy classes**), the underwriting characteristics and marketing objectives for the product, and any additional factors the actuary believes are appropriate.”

3.4.2.4(c) – We suggest striking this language.

~~“Determine new **NGE scales** such that the prospective profitability from the time of revision, including the prospective pattern of profits by duration, is not greater than that using the original **NGE scales** and original **anticipate experience factors**, holding all other assumptions constant.”~~

This language seems overly prescriptive and better suited for a regulation that limits an insurer’s discretion, rather than in an ASOP that is intended to guide an actuary’s use of professional judgement. We find that it is unsuitable for the requirements within an ASOP to prescribe an insurer’s profitability. We think that the ASB’s intent may be to provide a safe harbor example of one way to evaluate whether a new NGE scale represents equitable treatment. However, as written, it unduly constrains both the actuary’s professional judgement and the insurer’s discretion in evaluating whether new NGE scales are equitable. Striking this language would further require modifying 3.4.1(f) and 4.1(g) to remove the reference to 3.4.2.4(c).

3.5 – NGEs Used in Illustrations – We suggest deleting the following two sentences from this section.

~~“The actuary should not recommend illustrated NGE scales that are more favorable to the policyholder than those produced in accordance with section 3.4. The actuary should consider conducting tests of illustrated NGE scales to ascertain whether the illustrated NGE scales are supportable using anticipated experience factors that are not more favorable than actual recent historical experience.”~~

The first sentence (“The actuary should not...”) seems to prohibit an actuary from recommending an illustrated NGE scale that is more favorable than the actual/declared NGE scale that they are *also* recommending for certain in-force products not subject to ASOP 24. This situation seems highly unlikely. The more commonly encountered situation is where experience has deteriorated such that the current illustrated NGE scale is no longer supportable. This situation has already been addressed in the Annual Statement Exhibit 5 Interrogatory 3 Attachment, question 7. If the ASB feels this situation needs to be addressed, we believe it would be better addressed in a regulation limiting an insurer’s discretion, rather than in an ASOP guiding the actuary’s use of professional judgement.

The second sentence seems to be both unnecessarily prescriptive and inappropriate in an ASOP guiding the actuary’s use of professional judgement. The insurer’s determination policy and the actuary’s professional judgement should determine the appropriate relationship between historical experience and anticipated experience in determining both actual/declared and illustrated NGE scales for products not subject to ASOP 24. There are many instances and examples where historical experience is not a good indicator of future experience, including equity performance, interest rates, and credit cycles in times of economic stress, policyholder behavior when product innovations are introduced, and mortality when medical advances occur. Even though this sentence is written as a “should consider” rather than a “should”, we believe it is unnecessary and inappropriate, and that it would be appropriate to strike it. We believe that the sensitivity analysis and observations included in 3.4.2.2(f) and 4.1(i) provide sufficient guidance to address any situation where the anticipated experience deviates from historical experience.

Conclusion


While we are confident that the exposure draft is the product of much thought and effort by dedicated volunteers, we also believe that it would be improved by our suggestions above as well as those that others may provide. It is critical that the exercise of the insurer’s discretion and the actuary’s professional judgment not be unduly limited in situations that have not been previously contemplated or experienced. We hope that the next Exposure Draft will restore the appropriate and necessary flexibility needed to responsibly manage NGEs.

Thank you again for the opportunity to share our views, and to provide comments and suggestions. We are supportive of appropriate revisions to this ASOP. Please feel free to contact one or more of us with any questions or further discussion.

Sincerely,

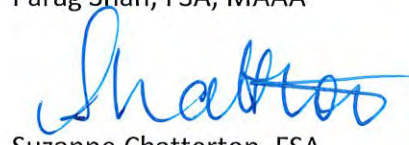

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