ASOP 2 Nonguaranteed Elements for Life Insurance and Annuity Products
Second Exposure Draft – November 13, 2020

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Comments related to Section 3.2.b; 3.4.1.g; 3.4.2.4.c

Recommendation:

Reinstate the guidance regarding prospective pattern of profits by duration as was included in the first exposure draft.

Rationale for Recommendation:

The referenced sections all relate to changes in the latest exposure draft on recouping past losses or distributing past gains. The committee removed the strong wording found in the first exposure draft about prospective durational pattern of earnings.

The Academy Task Force reviewing the first exposure draft commented, "recouping past losses and distributing past gains is a company-specific or public policy decision. Regulator and/or shareholder views on this practice may change over time. Thus, we believe Section 3.2 is too rigid. Furthermore, because non-actuarial company executives and board members are not bound by ASOPs, the guidance in sections 3.2 and 3.4 could potentially put the actuary in an impossible position…In addition, requiring that the profit pattern by duration after a redetermination never exceeds the profit pattern at original determination imposes a requirement that is inconsistent with current actuarial practices (except in Ney York under Regulation 210)."

In the second exposure draft the mention of "prospective pattern of profits by duration" now appears as an example of a method in 3.4.2.4.c. Sections 3.2.b, 3.4.1.g, and 3.4.2.4.c in the second exposure draft directs the actuary to determining NGE scales using a "method" at least requiring the present value of profits to be equated and "how the guidance in section 3.4.2.4 may constrain the ability to revise NGE scales after issue." (3.4.1.g)

A method constraining the ability to revise NGE scales after issue would include restricting the prospective pattern of profits by duration. I contend, it is the *only* method which would constrain the ability to revise NGE scales. By including the requirement in the first exposure draft, the committee must have felt a method restricting prospective pattern of profits by duration was appropriate.

Actuaries can design products which front-end profits at issue – any late duration losses would not significantly impact the present value of profits at issue when discounted. Likewise, at NGE (COI) redetermination actuaries can incorporate prospective front-end profits – here the pattern of profits going forward would exceed what was designed at pricing especially where losses were anticipated and the COI increase is designed to recover the profit shortfalls pushing even greater losses out into the future. This re-design may still equate at the duration of redetermination present value of prospective profits, but if the prospective present value of profits is calculated one duration later (and for each successive duration thereafter) the present values will not be equitable – the redesigned structure will be higher in the immediate durations from redetermination because of the fronting of profits implying recoupment of past losses.

The Academy Task Force noted a “pattern of profits” requirement is inconsistent with current actuarial practice. If the Task Force accepts equating the present value of profits as of the duration of redetermination as “consistent with current actuarial practice”, then calculating the present value at each successive duration is akin to analyzing the prospective pattern of profits as of the duration of initial redetermination.

Under the redesign, not only has the pattern of earnings changed but also so has the “deal” with the policyholder. Companies would be in a position to design products at original pricing purposefully employing assumptions with the intent of knowing NGEs could be changed in the future to overcome any mispricing. Policyholders rely on the company for fairness.

I agree with the Academy Task Force, company management retains complete discretion for establishing and redetermining all nonguaranteed elements and are not bound by actuarial standards of practice, but they are bound by the principle of fairness. If company management establishes NGEs in a manner to recoup past losses (disregarding the advice of the actuary), I agree this may put the actuary in a potentially impossible position. However, the Code Precept 1 impresses the actuary to “act truthfully, with integrity and competence in a manner to fulfill the profession’s responsibility to the public…”

The Academy Task Force and other comments to the first draft mention only one regulator has codified restricting recouping past losses or distributing past gains to 2 standards – (1) equating the prospective present value of profits and (2) equating the prospective pattern of profits by duration. The comments point out ASOPs should not regulate and only one regulator has codified this method of redetermining NGEs. By including the double standard in the first exposure draft, the committee must have felt it was appropriate regardless of how many (or how few) regulators codified the method.

The second exposure draft instructs the actuary in 3.2.4.2.c to use a method leading the actuary to an example in which prospective pattern of profits by duration is the example. I contend, this is the only method which properly from an actuarial perspective, “may constrain the ability to revise NGE scales after issue” based on the guidance of 3.4.2.4.c.

I recommend the committee reinstate the guidance regarding prospective pattern of profits by duration as was included in the first exposure draft.