

Title of Exposure Draft: ASOP No. 2

Comment Deadline: November 13, 2020

To Whom It May Concern:

The Life Practice Council of the American Academy of Actuaries has formed a task force to review the proposed revision of Actuarial Standard of Practice (ASOP) No. 2, *Nonguaranteed Elements for Life Insurance and Annuity Products* (the "Second Exposure Draft").

In general, we support further guidance in ASOP No. 2. The current ASOP could benefit from additional guidance and we agree with the ASB's decision to review and update it. Nonguaranteed elements (NGEs) are core features in many life insurance and annuity products in the industry, so it is critical that there be a useful standard for reasonable actuarial practice.

Although the task force supports efforts to revise ASOP No. 2 and agrees with many of the proposed changes, we continue to have many of the same concerns about the Second Exposure Draft that we expressed for the First Exposure Draft:

- The proposed guidance is **more restrictive** in certain areas than what is required by regulation in most jurisdictions and what is commonly permitted in contract language.
 - This will create undue hardship for actuaries when their non-actuarial principals choose to follow the law and not the ASOP.
 - The Second Exposure Draft attempts to prescribe enterprise-wide business decisions, which is outside the reach of a standard of practice for actuaries.
- In many cases, the proposed guidance is **ambiguous**.
 - If these ambiguities are not resolved, the proposed ASOP will fail to provide actuaries with a clear standard of practice and will not serve to support reasonable professional conduct for an actuary's defense in any civil or professional disciplinary action.

Many, but not all, of our concerns stem from the requirements in proposed sections 3.2a and 3.2b:

- The language in 3.2a that NGE scales should be revised only if anticipated experience factors have changed since issue or the prior revision is more restrictive than what is required by regulation in most jurisdictions and what is commonly allowed in contract provisions.
 - This proposed requirement may place an actuary in a difficult position if the actuary's role as a board member, regulator, or receiver/liquidator necessitates important additional considerations.
 - This proposed requirement would prohibit an actuary from improving NGE scales simply for competitive reasons.
- The provision in proposed section 3.2b that NGE scales are not determined with the objective of recouping past losses or distributing past gains is more restrictive than regulations governing most jurisdictions and what is commonly included in contract language.
 - This requirement is inconsistent with the NAIC Model Unfair Trade Practices Act.
 - This proposed revision is inconsistent with the current ASOP.
 - It is difficult to define what constitutes "recouping past losses and distributing past gains," and no definition is offered in the proposed ASOP No. 2. Thus, this requirement creates a significant "gray area" of practice.
 - The proposed standard fails to recognize that there may be unanticipated and unknown situations where recouping past losses and distributing past gains is a prudent thing to do.
 - This provision may also place an actuary in a difficult circumstance if the actuary's role as a board member, regulator, or receiver/liquidator necessitates important additional considerations.

Furthermore, we have concerns about the structure of the Second Exposure Draft. For example:

- The intended differences between sections 3.2.2, *Providing Advice on Applying the Determination Policy*, and 3.4, *Determination Process for NGE Scales*, is not obvious. Many of our reviewers continue to confuse the two, and we believe section 3.2.2 could be misapplied in a civil action.
- The Second Exposure Draft attempts to distinguish between sections 3.2.1, *Providing Advice on Developing or Modifying the Determination Policy*, and 3.2.2, *Providing Advice on Applying the Determination Policy*. We recommend sharpening this distinction (perhaps with an example) because the current language is unclear, particularly given the inclusion of the language "evaluating whether to revise existing NGE scales" in 3.2.2.
- There is inconsistency between the requirements of proposed sections 3.2 (a) and 3.2.2 because 3.2 (a) requires that NGE scales can only be changed if anticipated experience factors change, while 3.2.2 does not impose that requirement.

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- Differences between an NGE Framework and a Determination Policy remain unclear. In practice, many organizations do not structure the underlying components as described in the Second Exposure Draft. It is therefore unclear how an actuary would comply with this ASOP because the actuary “should understand” the NGE framework but “should recommend” a revision to the Determination Policy. It is furthermore unclear to whom this recommendation should be made.

As a result of these concerns and others, we believe that structural changes are needed.

We have provided additional comments using the requested template below. We hope these comments are helpful. Please contact Khloe Greenwood (greenwood@actuary.org), the Academy’s life policy analyst, if you have any questions.

Sincerely,

Laura Hanson, MAAA, FSA
Chairperson, Task Force to Review ASOP No. 2
American Academy of Actuaries

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I. Identification:

Name of Commentator / Company
Task Force to Review ASOP No. 2 / Life Practice Council of the American Academy of Actuaries

II. ASB Questions (If Any). Responses to any transmittal memorandum questions should be entered below.

N/A

III. Specific Recommendations:

#	Commentator Recommendation	Rationale
1.2	Consider moving “Throughout this standard, the term <i>determination...</i> ” sentence up to 1.1.	This an important concept to identify before the word “determination” is used in 1.2. Otherwise, the prior sentence may be confusing.
1.2	We recommend removing “if applicable, illustration of NGEs.” If there is a need for a standard that applies to illustrations that are not covered by ASOP No. 24, we believe that standard would fit better in a different ASOP, not this one. Otherwise, the language should be modified to clarify how/when this ASOP applies to the illustration of NGEs.	While NGEs obviously do affect illustrations, we question whether the nature, rules, etc., surrounding illustrations do or should be required to have any effect on NGEs. ASOP No. 24 seems to say no. Also, the first sentence indicates “This standard applies to ... if applicable, illustration of NGEs for all life insurance and annuity products.” The fifth paragraph states “This standard does not apply to actuaries when performing actuarial services with respect to NGEs subject to ASOP No. 24.” This is confusing. It’s not clear how illustrations are seen as relating to setting NGEs. Therefore, we recommend removing illustration guidance from the ASOP.
1.2	We question whether this ASOP is sufficiently flexible to apply to redeterminations for in-force policies issued prior to when this ASOP takes effect. We recommend adding language in many of the later sections that acknowledges that some items may be achieved “to the extent possible.”	The redetermination policy required under this ASOP may possibly be incompatible with the determination policies and decisions made when the policy was issued, causing difficulties in implementing a redetermination in accordance with this Second Exposure Draft. An actuary may have determined its NGEs differently (perhaps for future profitability or logistics purposes) if they were aware of these requirements at issue.
1.2	We note that this ASOP does not apply to policyholder dividends, but question whether there is a clear definition of what constitutes a dividend. ASOP No. 15 does not appear to define a dividend. We recommend more clarity on this issue.	Dividends could be defined by contractual references. They could be defined by whether they recoup past losses, etc. But given that the ASOP recognizes that non-dividend NGEs could be included in participating contracts, it seems that there needs to be some clarity on this in the ASOP.
1.4	We question whether four months is a reasonable amount of time to implement the requirements of this ASOP. Six months would be more reasonable.	

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2.1	An assumption of future experience used in the determination of NGEs. Examples of anticipated experience factors include rates of investment income, mortality, morbidity, policy persistency, and expense, expenses, and policyholder elections <u>such as policy persistency, premium persistency, and choice of other contractual options.</u>	Investment income is broader than rates of investment income. It was also unclear whether “rates of” applied to “investment income” only or the entire list. NGEs for flexible plans like universal life may need to consider more than just policy persistency.
2.2, 2.5	We recommend simply defining a “Determination Policy” as inclusive of both of these terms.	See our suggested change to 3.1 below.
2.3	“...guaranteed elements <u>typically</u> include...”	The examples may not include all guaranteed elements or may not all be included in a contract.
2.3	“...are <u>typically</u> specified in the policy...”	Although we cannot think of any examples, this would capture guaranteed elements that are not included in a policy.
2.4	“An NGE may <u>be more favorable</u> to the policyholder than a <u>guaranteed element.</u> ”	Suggested rewording for clarity.
2.4	“...and may be changed at the discretion of the insurer.”	We question whether this language precludes changes that are made based on a formula or index.
2.6	Delete	Use of the term “NGE <u>Scale</u> ” makes this ASOP too COI-focused, particularly because the example of an NGE Scale references COI charges. If there is a need to specify rules for a scale of NGEs, it is perhaps best to specify those rules in the ASOP, rather than making a general term that applies to both a single NGE and a series. Alternately, NGEs could be defined to include a series of NGEs.
2.6	Reference “anticipated experience factors” in the definition.	If this definition is kept, the NGE scale should be set based on anticipated experience factors consistent with 3.2a.
2.9	“A measurement used to assess a product’s expected <u>projected</u> level of financial results <u>profitability.</u> ”	“Product” seems to imply that determinations or redeterminations must involve determining profitability at a product level. The term “expected” can be interpreted in numerous ways, both in the statistical sense and in the colloquial sense. The term “projected” would add more specificity to the definition. The term “financial results” is vague and could be interpreted to mean earnings, surplus strain, investment performance, projected dividends, etc. If the intent is to focus on profitability (as implied by the term Profitability Metric), why not simply use “profitability?”

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3.1	We recommend either combining the NGE Framework and Determination Policy concepts OR better clarifying the difference between them.	<p>The concept of an NGE Framework generally is unclear. The components of the definition of an NGE Framework itemized in section 2.5 are nearly always today embedded in an insurer’s Determination or Redetermination Policy. In this Second Exposure Draft, the Determination Policy is one element of the NGE Framework. Therefore, the distinction between the NGE Framework and the Determination Policy is either trivial or unclear. Further, some insurance companies build in their Determination Policy provisions into Annual Statement Interrogatories. It is not clear how this would be done in an NGE Framework world.</p> <p>The examples provided in the Second Exposure Draft of items “commonly found” within the NGE Framework describe items commonly found in Determination and Redetermination Policies today. The samples provided also lead one to conclude the NGE Framework can vary by product, market/distribution and by Determination versus Redetermination. This suggests that one insurer may have many NGE Frameworks. If true, this expectation (or result) should be mentioned more directly.</p> <p>We note that Determination Policy is a commonly used term in the industry, while NGE Framework is not.</p> <p>It is also confusing that the actuary needs to only understand the NGE Framework but should be more active in shaping the Determination Policy.</p>
3.1	Delete the paragraph that begins “Examples of items...” through the end of 3.1(j). Move specific examples to the definition of “NGE Framework.”	A list of examples may not be appropriate in the Recommended Practices section of the ASOP. It is unclear whether the list is intended to be a documentation requirement.
3.1(e)	Recommend deleting (e); if not, clarify.	This item is either ambiguous or of questionable relevance. What kind of income or costs are being contemplated? It is not clear whether the example is referring to product earnings, investment income, or something else. Because product income is typically projected based on product-specific analysis, it is not clear where the allocation reference applies. As for “costs,” it is not clear what this refers to or whether “costs” is synonymous with expenses (as opposed to capital costs, for example). Even if it refers to expenses, it is not clear whether the reference is to fixed/overhead expenses, which are among the most commonly allocated expenses. Perhaps an example of what is being referred to here would be helpful.
3.1(g)	“g. the marketing objectives, such as distribution strategy, target markets, and competitive objectives.”	We do not believe an insurer’s distribution strategy is commonly found in an NGE Framework. Further, the elements listed under g.) would appear to be consistent with items found in a Determination NGE Framework, but not a Redetermination NGE Framework, and we would recommend clarification in that regard.

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3.2(a)	We recommend deleting this language.	<p>The language is more prescriptive than the current language of ASOP No. 2. It fails to acknowledge that the policy language may require the insurer (and therefore the actuary) to follow a different revision approach. Finally, Paragraph 3.2 (a) would seem to prohibit an insurer from improving NGE scales simply for competitive reasons.</p> <p>Alternatively, we recommend removing language after “have changed” and adding language that references policy provisions, and allows situations where improvements in NGEs may be made without changes in anticipated experience factors.</p>

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3.2(b)	<p>NGE scales are determined based on reasonable expectations of future experience and are not determined with the objective of recouping past losses or distributing past gains.</p> <p>We do not support an ASOP mandate that NGEs cannot recoup past losses or distribute past gains. However, we could support a provision that the actuary should disclose whether, in the actuary’s opinion, NGEs are recouping past losses or distributing past gains.</p>	<p>As written, this provision (1) creates new “law,” (2) puts actuaries in a difficult position with their employers and the Actuarial Board for Counseling and Discipline, (3) is not defined, (4) is inconsistent with the NAIC Model Unfair Trade Practices Act, and (5) fails to acknowledge valid situations that may arise where recouping losses or distributing past gains may be a reasonable course of action.</p> <p>(1) <u>New “Law”</u>: This proposed language introduces a new requirement that does not appear in the current ASOP No. 2, nor in most policy forms. The current ASOP No. 2 language in fact acknowledges that recouping past losses may be part of an insurer’s Determination Policy. Today, only a few individual states prohibit recouping past losses by regulation.</p> <p>(2) <u>Difficult Position</u>: While actuaries can play a critical role in developing NGE scales, decisions to recoup past losses or distribute past gains are made at a business level and are not exclusively actuarial. Strictly limiting actuaries from making such recommendations may isolate rather than support actuaries. It may preclude actuaries’ acceptance and participation as business unit leaders and even as regulators or receivers where such decisions, and a full range of advice and recommendations, may be required.</p> <p>Actuaries are often given profitability goals and may have no authority or responsibility to set them.</p> <p>(3) <u>Unclear</u>: It is unclear what constitutes “recouping past losses and distributing past gains” and no such definition is offered in the revised ASOP No. 2. Thus, this requirement creates a significant “gray area” of practice.</p> <p>(4) <u>Inconsistency With NAIC Model Law</u>: This proposed requirement is inconsistent with the NAIC Model Unfair Trade Practices Act, which allows the payment of bonuses or abatement of premiums out of surplus accumulated from nonparticipating insurance.</p> <p>(5) <u>Receivership/Liquidation</u>: The proposed standard fails to recognize that there may be unanticipated and unknown situations where recouping past losses and distributing past gains is a prudent thing to do (e.g., receivership or liquidation).</p> <p>Additionally, there are numerous ways to recoup past losses or distribute past gains other than direct NGE scale changes; imposing this limitation on only one aspect of product management is unrealistically narrow.</p> <p>Disclosure would be more appropriate and would not unduly burden individual actuaries.</p>

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3.2.1 (a) - (f)	Replace repetition from the list in 3.1(a) - (j) with a reference to either the NGE Framework or the Determination Policy, as applicable.	Many of the items in this list are duplicative with 3.1(a) - (j). Repetition makes the ASOP unnecessarily difficult to understand.
3.2.2	Combine this section with 3.2.1.	An actuary will often be involved in both developing and applying NGE scales. Separate sections for developing and applying determination policy create unnecessary repetition and overlap. A single recommended practice for both is appropriate and will add clarity.
3.2.2 (b)	Coordinate the reference to options with ASOP No. 7's language on materiality, likelihood of antiselection, and impact on profitability metrics ("cash flows").	The impacts of material policyholder options can change significantly over time. Actuaries will benefit from consistent references to policyholder options across ASOPs.
3.2.2 (d)		The reference to reinsurance may be misconstrued as a requirement for post-reinsurance pricing.
3.3	Elaborate on the term "review."	The Second Exposure Draft recommends that an actuary review existing policy classes for a product within the insurer's NGE Framework in preparation for an assignment. Greater elaboration and guidance is needed because it is not clear what kind of review and the scope of the review is being recommended here. Examples could be helpful.
3.3	Add reference to the contractual language to link the concept of policy class to the contractual provisions.	It is important for the actuary to review contract language before establishing or making changes to policy classes.
3.3.1 (b)		We do not agree that a policy should be assigned to more than one policy class. Policy classes may be grouped for the purpose of setting NGEs (e.g., interest rates), but we do not believe that policies belong to more than one policy class. This provision may be inconsistent with the definition of Policy Class in section 2.8.
3.3.1 (e)	Delete the item that says that the actuary should not expect to redefine policy classes after issue.	This is not a requirement in the current ASOP No. 2 and is confusing as to its meaning. For example, many insurers group policies into investment generation classes for purposes of credited interest rates, but then merge such policies into a portfolio rate class at some future duration, whether or not interest rates changed. We do not believe this should be prohibited. If this item is not removed, an example would be useful to clarify.
3.3.2		We believe this section should recognize that some policies cannot be reassigned if the actuary is limited by contract language.
3.3.2		We question whether the example describing a change in premium tax is helpful and suggest that a more common example could be identified.
3.4		We question whether the word "relationship" is appropriate in (b) and (f). In (f), we suggest "impact." We do not have a suggestion for (b).
3.4	Combine with section 3.2.	It is not clear what the differences are intended to be between the requirements of section 3.2 and section 3.4. The final sentence of section 3.4 discusses a potential conflict with guidance from sections 3.2 and 3.2.1, and recommends that the actuary consider providing advice consistent with section 3.2.2. An example of what this guidance is pointing toward would be helpful, because as mentioned above, it is not apparent why both sections 3.2 and 3.4 are necessary.

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3.2.1 (e), 3.2.2 (c), 3.4 (f)	Make consistent; also clarify what it means to take into account or have a relationship to reserves, capital, and surplus.	It is unclear why these lists are different, and we also do not understand what it means to have a relationship between reserves, capital, and surplus. Finally, in some of these lists, we do not understand why these items are called out specifically without recognizing that additional items may be considered also.
3.4.1 (c)	Delete.	It is unnecessary to restrict unless state law restricts this. Practical example: New management may buy a block and have different profit expectations. See also comments related to 3.2(a). We also question whether this item would prohibit an actuary from grading into a change over time.
3.4.1 (d)	Delete.	This is included in (f).
3.4.1 (g)	Delete.	This is a circular and refers to 3.4.2.4, which in turn refers back to 3.2 (a) and (b). This is confusing.
3.4.1		We question whether this section works for principals that set rates based on the market or based on an index.
3.4.1		We note that this entire section appears to be biased toward negative NGE changes and toward COIs. Here and throughout the ASOP, there does not seem to be a distinction between changes that are made frequently (e.g., interest rates, caps) and changes that are made less frequently (e.g., COIs).
3.4.2		We note the fact that anticipated experience factors can always be changing. Throughout this section, it is unclear whether the anticipated experience factors being referenced are those that were identified in the past, those that are currently experienced, or those that are expected in the future. This is important to clarify because the ASOP describes making comparisons to anticipated experience factors.
3.4.2.2		We question whether this section could be interpreted to say that favorable past experience must be reflected in future anticipated experience factor; we note that reflecting past experience is similar to reflecting past gains and losses, so it is important to clarify meaning here to avoid a gray area of practice.
3.4.2.2		Does this section prohibit an actuary from reflecting anticipated effects of COVID-19 even if changes have not been seen yet?
3.4.2.2	We recommend noting that experience can come from a variety of sources.	
3.4.2.2	We do not believe this section should be limited to the determination of in-force policies.	Analyzing experience is important for new business as well.
3.4.2.3 (e)	Instead of "at issue" and "in-force," we recommend referencing "determination" and "redetermination."	We believe that structuring the ASOP in this manner would help focus the content.
3.4.2.3 (j)	"...impacts on the policyholder <u>behavior</u> or the insurer..."	We believe impacts to policyholder <u>behavior</u> are more appropriate for an ASOP.

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3.4.2.4 (c)	Reframe the example; strike “including the prospective pattern of profits by duration.”	We note that the example can be difficult to achieve in practice (e.g., when mortality has different slope). Only New York has this requirement; thus, we suggest noting that this type of approach may be necessary to comply with applicable law, and remove the broader statement that “it may be appropriate.”
3.4.2.4		Seems to conflict with the last paragraph in 3.4 when referencing 3.2.
3.4.2.4	Replace “appropriate level of analysis” with language more similar to 3.4.2.3(g).	“Appropriate level of analysis” is vague.
3.4.2.4	Combine or sync with 3.4.2.3.	Much of the content is redundant; if keeping the sections separate, we recommend referencing 3.4.2.3, not repeating the content.
3.4.2.5	Add an example.	We are unsure of when this would occur, so an example would help clarify.
3.5	Delete.	This section does not fit the rest of the ASOP and contains little guidance; if guidance is needed for illustrations not subject to ASOP No. 24, we suggest either expanding ASOP No. 24 or creating a new ASOP.
3.6	Clarify “regulatory opinion.”	We are unsure of what is meant by “regulatory opinion.” (Is this an opinion from a regulator? To a regulator? Both? Neither?)
4.1(p)	Combine with (g).	We question whether a new anticipated experience factor needs special documentation beyond that which is already required in (g).
4.1(q)	Delete.	See 3.5.

IV. General Recommendations (If Any):

Recommendation	Rationale
Replace or define “take into account.”	We do not know what “take into account” means and how it differs from “consider” or “reflect.” This language is used repeatedly throughout the standard, so it is important that actuaries understand what it means.
Restructure the ASOP to remove redundancies.	Some content seems redundant, which leads to circular references. For example: <ul style="list-style-type: none"> • 3.2.1 developing/modifying policy, 3.2.2. applying policy, 3.3.2 in-force policies. • Lists of considerations for 3.4 determination process for NGE scales, 3.4.1 process for future of new or existing product and 3.4.2 in-force policies. Repetition can also cause ambiguity where similar concepts are repeated using different language.
Review for applicability to annuities (including fixed indexed annuities and variable annuities) and make appropriate changes.	The ASOP is very life insurance-/COI-focused.
Differentiate between routine NGE changes and more complex NGE changes.	The Second Exposure Draft does not generally differentiate between more routine NGE changes (e.g., changes to credited rates due to market interest movements) and more complex NGE changes (e.g., changes to cost of insurance [COI] rates). Much of the guidance in the standard would be excessive for more routine NGE changes.
Place more emphasis on determination.	The ASOP is heavily focused on redetermination but seems to be light on guidance for determination.

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Review for favorable changes to NGEs and make appropriate changes.	The ASOP is written assuming that NGE changes will be unfavorable to the consumer; it is unclear whether the actuary can improve an NGE or reverse an increase without the full analysis described in the ASOP.
Review for alternative rate-setting processes and make appropriate changes.	The ASOP is written assuming that changes to NGEs are based on (new) actuarial analysis vs. following an established plan (e.g., tracking an index or market rates).
Review for company actuary perspective and make appropriate changes.	The descriptions of the actuary's role in setting and applying the determination policy continue to seem very distant and disconnected, as though the Second Exposure Draft is written for a consultant and not a company actuary.

V. Signature:

Commentator Signature	Date
Laura Hanson, MAAA, FSA, Chairperson Mary Bahna-Nolan, MAAA, FSA Sue Bartholf, MAAA, FSA Matt Monson, MAAA, FSA Tim Pfeifer, MAAA, FSA Chuck Ritzke, MAAA, FSA Jim Thompson, MAAA, FSA	November 12, 2020