



ACTUARIAL STANDARDS BOARD

**Actuarial Standard
of Practice
No. 33**

**Actuarial Responsibilities
with Respect to Closed Blocks in
Mutual Life Insurance Company Conversions**

**Developed by the
Closed Block Task Force of the
Life Committee of the
Actuarial Standards Board**

**Adopted by the
Actuarial Standards Board
January 1999**

Updated for Deviation Language Effective May 1, 2011

(Doc. No. 150)

TABLE OF CONTENTS

Transmittal Memorandum

iv

STANDARD OF PRACTICE

Section 1. Purpose, Scope, Cross References, and Effective Date	1
1.1 Purpose	1
1.2 Scope	1
1.3 Cross References	1
1.4 Effective Date	1
Section 2. Definitions	1
2.1 Applicable Law	1
2.2 Closed Block	2
2.3 Individual Policy	2
2.4 Initial Assets	2
2.5 Initial Liabilities	2
2.6 Operating Rules	2
2.7 Reasonable Dividend Expectations	2
2.8 Reinvestment Rate	2
2.9 Tontine	2
Section 3. Analysis of Issues and Recommended Practices	2
3.1 Objectives of the Closed Block	3
3.2 Policy Inclusion Criteria	3
3.3 Determination of Funding	3
3.4 Funding Assumptions	3
3.4.1 Reinvestment Rate	3
3.4.2 Mortality and Morbidity	5
3.4.3 Lapses	5
3.4.4 Commissions and Expenses	5
3.4.5 Taxes	5
3.4.6 Other Factors	5
3.5 Operating Rules	5
3.5.1 Insurance Cash Flows	5
3.5.2 Investment Cash Flows	5
3.5.3 Commissions and Expenses	6
3.5.4 Taxes	6
3.5.5 Initial Liabilities	6
3.6 Closed Block Operation	6
Section 4. Communications and Disclosures	6
4.1 Reliance on Data Supplied by Others	6
4.2 Reliance on Asset Cash-Flow Projections Supplied by Others	6

4.3	Actuarial Report and Statement of Actuarial Opinion	6
4.4	Disclosures	7

APPENDIXES

Appendix 1—Background and Current Practices	8
Background	8
Demutualization Statutes	9
The Role of the Actuary	9
Appendix 2—Comments on the Exposure Draft and Committee Responses	11

February 1999

TO: Members of Actuarial Organizations Governed by the Standards of Practice of the Actuarial Standards Board and Other Persons Interested in Mutual Life Insurance Company Conversions

FROM: Actuarial Standards Board (ASB)

SUBJ: Actuarial Standard of Practice No. 33

This booklet contains the final version of Actuarial Standard of Practice No. 33, *Actuarial Responsibilities with Respect to Closed Blocks in Mutual Life Insurance Company Conversions*.

Background

In the past decade, an increasing number of mutual life insurance companies have converted to stock life insurance companies, sometimes including the formation of a mutual holding company. Demutualizations present important actuarial issues, including the preservation of reasonable policyholder dividend expectations and, in a traditional demutualization, the allocation among eligible policyholders of the compensation due them in exchange for their membership rights (i.e., consideration).

This actuarial standard of practice (ASOP) deals with actuarial responsibilities with respect to closed blocks, which have often been used as devices to preserve reasonable policyholder dividend expectations. (This ASOP addresses situations in which a closed block is used; it does not require that a closed block be used.) Actuaries are often involved in all aspects of a closed block, including advising on the types of policies that should be included, the initial funding, and the development of the operating rules; and in reviewing actual operations once a closed block has been established.

Drafting Issues

A draft of this standard was exposed for review and comment in a document dated May 1998, with a comment deadline of September 1, 1998. Eighteen comment letters were received. The Life Committee's Closed Block Task Force and the committee members reviewed each comment carefully and made a number of changes to the exposure draft in response (see appendix 2).

The comment that prompted the most discussion was one that objected to the approach taken in the exposure draft to setting the reinvestment rate when the investment policy of the closed block differed from that underlying the current dividend scale. The committee made two changes in response to this letter.

1. The committee added the following sentences:

Usually, policyholders would not expect that the company's investment policy for new assets would change as a result of the establishment of the closed block. Therefore, policyholders' reasonable dividend expectations are most likely to be met if the investment policy for new assets to be purchased with the closed block's cash flows is the same as the investment policy underlying the current dividend scale.

2. The committee replaced a requirement that the actuary consider any change in investment policy with a requirement that the actuary fully disclose the effect of any non-recognition of a change in investment policy.

The Closed Block Task Force and the Life Committee thank all those who commented on the exposure draft. The ASB voted in January 1999 to adopt this standard.

Closed Block Task Force

Godfrey Perrott, Chairperson

Kenneth M. Beck

Dale S. Hagstrom

Charles Carroll

William C. Koenig

Gary Corbett

Life Committee of the ASB

Lew H. Nathan, Chairperson

John W. Brumbach

Stephen G. Hildenbrand

Frank J. Buck

Walter N. Miller

Marc A. Cagen

Godfrey Perrott

Mark Freedman

Thomas A. Phillips

Jane L. Hamrick

Roger K. Wiard-Bauer

Actuarial Standards Board

David G. Hartman, Chairperson

Phillip N. Ben-Zvi

Roland E. King

Heidi R. Dexter

William C. Koenig

Ken W. Hartwell

Alan J. Stonewall

Frank S. Irish

James R. Swenson

ACTUARIAL STANDARD OF PRACTICE NO. 33

ACTUARIAL RESPONSIBILITIES WITH RESPECT TO CLOSED BLOCKS IN MUTUAL LIFE INSURANCE COMPANY CONVERSIONS

STANDARD OF PRACTICE

Section 1. Purpose, Scope, Cross References, and Effective Date

- 1.1 Purpose—The purpose of this standard is to define the responsibilities of an actuary when the actuary is asked to advise on, review, or opine on a proposed or existing closed block formed in connection with a mutual life insurance company conversion.
- 1.2 Scope—This standard of practice applies to actuaries who perform professional services in connection with the design and operation of a closed block in conjunction with the conversion of a mutual life insurance company to a stock life insurance company, including conversion to a mutual holding company structure.
- If the actuary departs from the guidance set forth in this standard in order to comply with applicable law (statutes, regulations, and other legally binding authority), or for any other reason the actuary deems appropriate, the actuary should refer to section 4.
- 1.3 Cross References—When this standard refers to the provisions of other documents, the reference includes the referenced documents as they may be amended or restated in the future, and any successor to them, by whatever name called. If any amended or restated document differs materially from the originally referenced document, the actuary should consider the guidance in this standard to the extent it is applicable and appropriate.
- 1.4 Effective Date—This standard will apply to any actuarial work performed or opinions issued on or after June 1, 1999.

Section 2. Definitions

The definitions below are defined for use in this actuarial standard of practice.

- 2.1 Applicable Law—Federal, state, and local statutes, regulations, case law, and other binding authority that may govern the conversion of the subject mutual life insurance company to a stock life insurance company, including conversion to a mutual holding company structure.

- 2.2 Closed Block—A mechanism to preserve (over time) the reasonable dividend expectations of policyholders with individual life, health, or annuity policies. A closed block comprises a defined, limited group of policies and a defined set of assets, and is governed by a set of operating rules. All cash flows arising from the closed block are exclusively committed to supporting the policies in the closed block as specified in the operating rules.
- 2.3 Individual Policy—Any policy (or contract) that is defined as an individual policy under state insurance law or by the terms of the policy. Any certificate issued under any other policy that is sold to a passive trust but is marketed to individuals is also defined as an *individual policy* for purposes of this standard.
- 2.4 Initial Assets—The assets allocated to a closed block at its inception. The assets of the closed block may be either of the following:
- a. a distinct segment of assets (which may contain either 100% or a specified fraction of each designated asset) associated exclusively with the closed block; or
 - b. a defined share of a larger segment of assets. Such larger segment may also contain assets associated with participating business sold after the date of conversion. Such defined share will vary from time to time according to the methodology specified in the operating rules.
- 2.5 Initial Liabilities—The obligations ascribed to the closed block at its inception by the operating rules.
- 2.6 Operating Rules—All portions of the plan of conversion that specify the methods and procedures for setting up, maintaining, and monitoring the operations of a closed block.
- 2.7 Reasonable Dividend Expectations—The expectations that the current dividend scale will be maintained if the experience underlying the current scale continues, and that the dividend scale will be adjusted appropriately if the experience changes.
- 2.8 Reinvestment Rate—The assumed yield rate on assets to be purchased with the closed block's cash flows.
- 2.9 Tontine—An outcome of a closed block in which relatively few last surviving policyholders receive dividends substantially disproportionate to those previously received by other policyholders in the same closed block, particularly policyholders who had persisted for a considerable period.

Section 3. Analysis of Issues and Recommended Practices

The actuary may be requested to advise on, review, or opine on various aspects of the closed block. In doing so, the actuary should be guided by the following:

- 3.1 Objectives of the Closed Block—The objective in establishing the closed block is to preserve the reasonable dividend expectations of each class of policyholders. After the closed block is established, the objective is to manage aggregate dividends so as to exhaust the assets when the last policy terminates, while avoiding the creation of a tontine.
- 3.2 Policy Inclusion Criteria—Policies included in a closed block should be reasonably expected to generate experience-based policy dividends over which the company has significant discretion. Policies chosen for inclusion should be such that the number of policies will decrease to zero in a finite time. These policies are usually individual policies. Practical considerations may result in the inclusion of other policies.
- 3.3 Determination of Funding—The actuary should ensure that the initial assets, together with the anticipated revenue from the closed block business, are reasonably expected to be just sufficient to permit the closed block to pay all policy benefits, including dividends according to the current dividend scale, and other items identified in the operating rules, if the funding assumptions are realized. These assets should include all policy loans and due and deferred premiums on policies in the closed block. It is customary to assign to the closed block the due and accrued investment income on the initial assets.

The actuary should be satisfied that the methods and assumptions used to calculate the amount of the initial assets are consistent with the operating rules and the assets' characteristics. If the actuary finds that the operating rules are ambiguous, then the actuary should state, in his or her written report, the interpretation he or she used to determine the funding.

- 3.4 Funding Assumptions—The actuary should select assumptions consistent with the recent experience underlying the current dividend scale for the closed block policies; these assumptions are not necessarily the factors used in the dividend formula. The actuary should use his or her best estimates of cash flows from the initial assets and the reinvestment rate assumption described in section 3.4.1. The actuary should review the data relevant to an assumption. If the data are inconclusive, the actuary may include a modest provision for uncertainty that is designed to increase rather than reduce the amount of initial assets.
- 3.4.1 Reinvestment Rate—The actuary should choose a reinvestment rate assumption that is directly related to the company's practice for determining its current dividend scale for business to be placed in the closed block. Dividend structures commonly fall into one of three types:

- a. Portfolio Rate—If the company uses a dividend scale based on a portfolio rate, then the reinvestment rate should be equal to the portfolio rate that underlies the current dividend scale.

- b. **Segmented Portfolio Rate**—If the company uses a dividend scale based on asset segments or an investment generation method to allocate investment income among generations of policies or among different products, then multiple projection segments with different reinvestment rate assumptions are used. The reinvestment rate for each projection segment should be equal to the segment portfolio rate that underlies the current dividend scale for that generation of policies.
- c. **Generational Rate**—If the company uses a dividend scale that credits investment returns to each policyholder based on the investment generations of that policy's cash flows, then the reinvestment rate should be equal to the investment rate that underlies the rate being credited on current cash flows.

If capital gains and losses have been reflected in some way in the investment rate underlying the current dividend scale, then the actuary should include those gains or losses in a consistent fashion in determining the reinvestment rate assumption.

If the investment rate underlying the current dividend scale reflects gains from other sources (such as group lines of business or earnings on surplus), then the actuary should not include the effect of such gains in setting the reinvestment rate assumption, unless the operating rules provide for crediting such gains to the closed block.

Usually, policyholders would not expect that the company's investment policy for new assets would change as a result of the establishment of the closed block. Therefore, policyholders' reasonable dividend expectations are most likely to be met if the investment policy for new assets to be purchased with the closed block's cash flows is the same as the investment policy underlying the current dividend scale. However, if the closed block investment policy is different from the investment policy underlying the current dividend scale, the actuary may, notwithstanding earlier provisions of this section, modify the reinvestment rate assumption to reflect the change. If the change in investment policy is not fully reflected in the reinvestment rate assumption, the actuary should disclose this fact in his or her opinion. The disclosure should include the following:

- a. the extent to which this change in investment policy was not reflected in the reinvestment assumption;
- b. the rationale for having not fully reflected this change; and
- c. whether future dividend scales are expected to be higher or lower as a result of having not fully reflected this change.

If the plan of conversion does not specify an investment policy for new assets to be purchased for the closed block, the actuary should obtain a statement of such investment policy from company management and refer to it in the actuarial report and statement of actuarial opinion (see section 4.3).

- 3.4.2 Mortality and Morbidity—The actuary should select assumptions that are consistent with the experience underlying the current dividend scale for the closed block policies.
- 3.4.3 Lapses—The actuary should choose a lapse assumption that is consistent with company experience. Experience data antedating public knowledge that the company was considering converting are preferable to later experience data, which may have been distorted by the announcement.
- 3.4.4 Commissions and Expenses—The treatment of commissions and expenses should be in accordance with that detailed in the operating rules (see section 3.5.3).
- 3.4.5 Taxes—The treatment of taxes should be in accordance with that detailed in the operating rules (see section 3.5.4).
- 3.4.6 Other Factors—The actuary should take into account the company's recent experience with respect to other relevant factors, such as dividend options, nonforfeiture options, reinsurance, conversions, or riders.
- 3.5 Operating Rules—The operating rules are an integral part of the plan of conversion of the mutual life insurance company. Any actuary drafting or reviewing the operating rules should ensure that the operating rules cover all charges and credits to the closed block, including at least the treatment of insurance cash flows (including reinsurance, if any), investment cash flows, and the bases for charging commissions, expenses, and taxes; and that the initial assets and liabilities are defined.
 - 3.5.1 Insurance Cash Flows—The operating rules should set forth the procedure for crediting and charging cash flows related to policy premiums and benefits to the closed block. For example, cash premiums, cash repayments of policy loans, and policy loan interest paid in cash on closed block policies would usually be credited to the closed block; death, surrender, and maturity benefits paid in cash, policy loans taken in cash, annuity and other income benefits, and dividends paid in cash would usually be charged to the closed block.
 - 3.5.2 Investment Cash Flows—The operating rules should specify which investment earnings or cash flows should be credited or charged to the closed block. For example, cash flows related to the assets allocated to the closed block, such as dividend and interest payments, and maturities and sales of assets, would usually be credited; brokerage expenses and other expenses directly related to the acquisition, maintenance, or sale of a closed block asset would usually be charged to the closed block.

- 3.5.3 Commissions and Expenses—The operating rules should specify the method for calculating future commission and expense charges, if any, to the closed block.
- 3.5.4 Taxes —The operating rules should specify the method for calculating any future tax charges to the closed block. Because a closed block is not a separate taxable entity, allocation methods will have to be developed for some tax items.
- 3.5.5 Initial Liabilities—The operating rules should specify each category of liability, and its amount, that will be assigned to the closed block at its inception. The asset valuation reserve (AVR) and interest maintenance reserve (IMR) are usually excluded from the closed block because they are not cash items.
- 3.6 Closed Block Operation—When advising a company on the operation of an existing closed block, the actuary should recommend a dividend scale that is consistent with the goal of exhausting the assets when the last policy terminates, while avoiding the creation of a tontine. When reviewing the operation of an existing closed block, the actuary should determine whether the total amount of dividends is consistent with this goal. In either case, the actuary should be mindful of the guidance found in ASOP No. 15, *Dividend Determination and Illustration for Participating Individual Life Insurance Policies and Annuity Contracts*, with respect to the allocation of dividends among classes of policies.

Section 4. Communications and Disclosures

- 4.1 Reliance on Data Supplied by Others—The actuary may rely on data supplied by another. In doing so, the actuary should disclose both the fact and the extent of such reliance. The accuracy and comprehensiveness of data supplied by others are the responsibility of those who supply the data. However, when practicable, the actuary should review the data for reasonableness and consistency. For further guidance, the actuary is directed to ASOP No. 23, *Data Quality*.
- 4.2 Reliance on Asset Cash-Flow Projections Supplied by Others—The actuary may rely on asset cash-flow projections or other analyses of assets supplied by others—for example, projections of real estate or equity assets. In doing so, the actuary should disclose both the fact and the extent of such reliance. The accuracy and soundness of projections supplied by others are the responsibility of those who supply the projections. However, when practicable, the actuary should review the projections for reasonableness and consistency.
- 4.3 Actuarial Report and Statement of Actuarial Opinion—At the time of the establishment of a closed block, an actuary who advises an employer or client concerning the closed block's development or who reviews a closed block under development on behalf of an employer or client should issue a written actuarial report or statement of actuarial opinion concerning the appropriateness of the closed block arrangements, unless another actuary advising the same entity is issuing such a report or statement. Each actuarial report or

statement of actuarial opinion usually should express an opinion concerning the classes of policies to be included in a closed block, the appropriateness of the operating rules of the closed block, and the sufficiency of the funding of the closed block, all in light of the objective of the closed block.

An actuary who advises an employer or client on the operation of a closed block that is already in existence, or reviews a closed block already in existence on behalf of an employer or client, should issue a written actuarial report or statement of actuarial opinion concerning the operations of the closed block, unless another actuary advising the same entity is issuing such a report or statement. Any such report or statement should address the subject described in section 3.6, and may also discuss other aspects of closed block operations.

An actuary who is testifying about a proposed or actual closed block should consult ASOP No. 17, *Expert Testimony by Actuaries*, for guidance on expert testimony.

4.4 Disclosures—The actuary should include the following, as applicable, in the actuarial report or statement of actuarial opinion:

- a. the disclosure in ASOP No. 41, *Actuarial Communications*, section 4.2, if any material assumption or method was prescribed by applicable law (statutes, regulations, and other legally binding authority);
- b. the disclosure in ASOP No. 41, section 4.3, if the actuary states reliance on other sources and thereby disclaims responsibility for any material assumption or method selected by a party other than the actuary; and
- c. the disclosure in ASOP No. 41, section 4.4, if, in the actuary's professional judgment, the actuary has otherwise deviated materially from the guidance of this ASOP.

Appendix 1

Background and Current Practices

Note: This appendix is provided for informational purposes, but is not part of the standard of practice.

Background

In the early 1980s, a few large mutual life insurance companies evinced an interest in demutualization. The Society of Actuaries (SOA) responded to this interest in 1984 by appointing a task force on mutual life insurance company conversion with the following charge: “To examine the actuarial issues involved in converting a mutual life insurance company to a stock form of ownership, and to produce a record of its examination.”

At that time there had been relatively few conversions of mutual insurance companies, and most of these had been conversions of property and casualty companies. The few mutual life insurance company conversions had involved relatively small companies or immediate acquisition by another company; many of the issues that a large, multi-line mutual life insurance company would encounter in a conversion to an independent stock life insurance company were new. To the extent that states had laws permitting such conversions, these laws had been derived from, or were identical to, laws applicable to conversions of property and casualty companies. There was relatively little actuarial literature on the subject.

The “Report of the Task Force on Mutual Life Insurance Company Conversion,” completed in July 1987 by the SOA (see *Transactions* 39 (1988): 295–391), covered what the task force considered to be the three principal actuarial aspects of a mutual life insurance company conversion: how to maintain policyholders’ reasonable dividend expectations; how to determine the aggregate amount of compensation due to policyholders in exchange for their membership rights; and how to allocate this aggregate amount of compensation among participating policyholders.

The report stated that the conversion plan should be designed to assure policyholders that their reasonable dividend expectations (i.e., that the current dividend scale would continue if current experience continued) would be met. Otherwise, policyholders would be required, when voting on the conversion plan, to weigh the compensation offered for the cancellation of their membership rights against the possibility of reduced dividends. The SOA task force considered a number of methods of maintaining policyholders’ dividend expectations and concluded that the closed block approach was the most promising for most individual coverages.

The SOA task force recognized that a closed block may not be appropriate or effective for all lines of business and, thus, that decisions must be made as to the classes of business to be

included in a closed block. To the extent that these decisions are not preempted or prescribed by statute, the task force suggested the following criteria:

1. If, for a class of policies, there is an expectation of substantial policy dividends and the company has significant discretion as to whether those dividends are paid and in what amounts, the class should probably be included in the closed block.
2. If the dividend structure for a class of policies is based more on broad averaging of costs than on policy-by-policy experience rating, the class should probably be included in the closed block. Policies that are experience rated largely on an individual basis should probably not be included.
3. Classes of policies included in the closed block should be expected to diminish in size with the passage of time and, eventually, to disappear. Any class of policies not expected to diminish over time probably should not be included.

Demutualization Statutes

Many states enacted legislation governing the conditions under which life insurance companies can convert to the stock form, both before and after the task force's report. For example, the New York statute requires that the plan of conversion be "fair and equitable to the policyholders." More particularly, the New York statute requires that participating business that is in force on the effective date of the conversion must be operated by the reorganized insurer as a closed block, for policyholder dividend purposes only. Some or all classes of group policies and contracts may be excluded from the closed block.

The past few years have seen the advent of the mutual holding company form of conversion. With this form, just as with a traditional demutualization, a mutual life insurance company is converted to the stock form of ownership. Ultimately, if not immediately, the converted life insurance company may have owners other than policyholders, and the policyholders' reasonable dividend expectations will need protection.

To date, all conversions that have involved outside (non-policyholder) shareholders, whether occasioned by traditional demutualization or by conversion to a mutual holding company structure, have, with minor exceptions, resulted in the formation of a closed block. Generally, only dividend-paying participating individual policies (including some group policies that were marketed and administered as individual) have been included within the closed block. Other protective mechanisms have sometimes been used for non-dividend-paying policies that contained some form of discretionary benefit.

The Role of the Actuary

The New York statute requires that "one or more qualified and disinterested actuaries," appointed by the superintendent, certify "the reasonableness and sufficiency" of the assets

initially allocated to the closed block. This certification must “be made in accordance with professional standards and practices generally accepted by the actuarial profession and such other factors as such actuary in his professional judgment believes are reasonable and appropriate.” Some states, Illinois being an example, require that an opinion of the actuary as to the sufficiency of the initial asset allocation “be based on methods of analysis deemed appropriate for those purposes by the Actuarial Standards Board.”

Actuaries are often involved in all aspects of a closed block, advising on the selection of policies to be included, the initial funding, and the operating rules, and, subsequently, reviewing the operation. Actuaries have acted in at least three roles: as the company’s own actuaries; as independent consulting actuaries who may both advise the company and provide independent opinions to management, the board of directors, policyholders, and to the state regarding certain aspects of the closed block; and as independent actuaries retained by a supervisory authority for advice and to provide one or more opinions on certain aspects of the closed block.

This ASOP reflects what is considered good practice used in the establishment of closed blocks up until this time. The unique circumstances and characteristics of each mutual company, however, make it impossible to state with confidence that the goal of protecting policyholders’ reasonable dividend expectations can be met, in all future transactions, without deviating from this standard in some way as yet unforeseen. The actuary is best qualified, of all participating professionals, to assess and analyze the particular circumstances and operating philosophies of the mutual company, as demonstrated over its history, in determining what actually constitutes “reasonable dividend expectations” and to recommend funding to that end.

Appendix 2

Comments on the Exposure Draft and Committee Responses

The exposure draft of the proposed standard was circulated for review in May 1998, with a comment deadline of September 1, 1998. Eighteen letters of comment were received. The Closed Block Task Force and the Life Committee carefully reviewed each comment and made a number of changes in response. Summarized below are the significant issues and questions contained in the comment letters, printed in roman. The committee's responses appear in **boldface**.

General Comments

Several comment letters did not apply to any particular part of the exposure draft. One letter approved of the proposed actuarial standard of practice (ASOP); another letter disapproved of the proposed ASOP and of the concept of closed blocks. One letter suggested that a closed block should be funded with assets equal to liabilities and profit transfers made periodically. Another letter requested guidance on how to avoid a tontine. Another letter suggested that guidance should be given on reinsurance that should be secured by the closed block to avoid mortality fluctuations. **The committee did not make any change to the ASOP as a result of these letters.**

One letter requested guidance on spreading deviations of actual from expected experience over several years. **The committee felt that this question was beyond the scope of this ASOP.**

Transmittal Memorandum

In the exposure draft's transmittal memorandum, the committee drew its readers' attention to three provisions in particular: section 3.4, Funding Assumptions; section 3.4.1, Reinvestment Rate Assumption; and section 3.4.5, Taxes. Please see those sections, below, for discussion of any pertinent readers' comments and committee responses.

Two commentators objected to the term *full demutualization*, which appeared elsewhere in the transmittal memorandum. **The committee changed the term to *traditional demutualization*.** Three letters suggested recognizing protection methods other than closed blocks. **The committee acknowledges that there are other valid methods, but believes them to be beyond the scope of this ASOP.**

Section 1. Purpose, Scope, and Effective Date

Section 1.3, Effective Date—One commentator suggested that section 1.3 should encourage earlier implementation of the ASOP. **The committee changed the effective date at the ASB’s direction.**

Section 2. Definitions

Five commentators requested a definition of *reasonable dividend expectations*. **The committee added such a definition (see section 2.7).** One letter commented on the definition of *individual policy* used; another letter requested a definition of *group policy*; a third suggested adding a definition of *initial liabilities*. **The committee edited the definition of *individual policy* (see section 2.3) slightly; decided not to define *group policy*; and added a definition of *initial liabilities* (see section 2.5).**

Section 3. Analysis of Issues and Recommended Practices

Section 3.2, Policy Inclusion Criteria—One commentator suggested that universal life insurance policies should be included in closed blocks and that the guidance on what policies should be included should be expanded. Several letters requested more examples. **The committee did not agree that more examples would clarify the proposed standard. The committee retained section 3.2 as written.**

Section 3.3, Determination of Funding—One letter suggested including due and accrued investment income in section 3.3. **The committee edited section 3.3 to include such income.** Two letters suggested editorial changes to section 3.3. **Some of the suggested editorial changes appear in the revised text.**

Section 3.4, Funding Assumptions—In the exposure draft’s transmittal memorandum, the committee asked for comment on this section as follows:

Section 3.4, Funding Assumptions, states that the assumptions should be consistent with the recent experience underlying the current dividend scale. An alternative position could be that the assumptions should be consistent with the experience underlying the dividend scale at the last time it was approved by the board of directors, which may have been several years ago. The Life Committee believes that the approach set forth in the exposure draft is preferable, but welcomes comments.

No comment letters directed to this point were received and the committee believes that the approach taken by the standard is appropriate.

One letter suggested that section 3.4 specifically refer to the possible use by a closed block of a slice of a larger portfolio. **Language has been added to the definition of *initial assets* (see section 2.4) to accommodate this suggestion.**

Several letters suggested editorial changes. **The committee adopted some suggested changes to improve clarity.**

Section 3.4.1, Reinvestment Rate Assumption (now titled Reinvestment Rate)—In the exposure draft's transmittal memorandum, the committee asked a specific question about this section as follows:

Section 3.4.1, Reinvestment Rate Assumption, provides for an adjustment to the reinvestment rate assumption if the investment policy for assets to be purchased for the closed block is different from the investment policy underlying the current dividend scale (i.e., the dividend scale in effect immediately prior to the establishment of the closed block). This statement implies that if the closed-block's cash flows are to be invested in assets significantly different, in type or maturity pattern, from assets underlying the current dividend scale, the reinvestment rate should be modified. For example, the investment policy might state that closed-block investments are not to include a substantial common stock component that underlies the current scale, or that closed-block assets are to be invested in debt instruments of significantly shorter maturities than those underlying the current scale. Should the ASOP provide more guidance in this area?

One comment letter objected to the approach taken in the exposure draft to setting the reinvestment rate when the investment policy of the closed block differed from that underlying the current dividend scale. **The committee made two changes in response to this letter:**

1. The committee added the following sentences:

Usually, policyholders would not expect that the company's investment policy for new assets would change as a result of the establishment of the closed block. Therefore, policyholders' reasonable dividend expectations are most likely to be met if the investment policy for new assets to be purchased with the closed block's cash flows is the same as the investment policy underlying the current dividend scale.

2. The committee replaced a requirement that the actuary consider any change in investment policy with a requirement that the actuary fully disclose the effect of any non-recognition of a change in investment policy.

One letter suggested that where the experience had changed dramatically since the dividend scale was set, but before the closed block was funded, current experience, rather than the experience underlying the dividend scale, should be used. **The committee found this to be inconsistent with the purpose and design of a closed block and made no change.**

Section 3.4.2, Mortality and Morbidity—One letter indicated that the commentator thought that section 3.4.2 referred to the dividend mortality rather than to the mortality underlying the dividend scale. **The committee believes that the meaning is clear.**

Section 3.4.4, Commissions and Expenses—One letter suggested that expenses should always be funded by the closed block. This is contrary to current practice. **The committee made no change.**

Section 3.4.5, Taxes—The committee had explicitly asked for comment on this section in the exposure draft's transmittal memorandum as follows:

Section 3.4.5, Taxes, does not discuss the treatment of the IRC Section 809 so-called equity tax on mutual insurance companies. Historically, this tax (even if it is still payable) has not been charged to the closed block in the operating rules and therefore has been ignored in the funding calculations.

Some dividend scales contain either an implicit or explicit charge to reflect the equity tax. The Life Committee considered whether the operating rules should specify making this charge to the closed block under the tax allocation procedures, provided the company was still subject to the equity tax. If the company were not subject to the equity tax, this charge would not be allocated to the closed block. Under this approach (which has not to our knowledge been followed in any transaction), the charge would be assumed in the closed-block funding calculations so that if and when the company were no longer subject to the equity tax, the closed-block policies would benefit to the extent they had been previously charged. The ASB Life Committee believes that the approach set forth in the exposure draft is preferable, but welcomes comments.

No letters on this point were received and the committee believes that the approach taken in the ASOP is appropriate.

A number of commentators made editorial suggestions, particularly with respect to section 3.4, Funding Assumptions, and section 3.5, Operating Rules. **The committee considered all editorial suggestions and adopted a number of them.**

The Closed Block Task Force and the Life Committee of the ASB thank everyone who took the time and made the effort to submit comments.