# Alternative Methodology

Proposal:

* Retain the Alternative Methodology for both reserve and RBC calculations applicable to the same scope of products.
* Retain the reserve calculations defined in VM-21 without adjustment.
* Eliminate the requirement for the additional standard projection amount for contracts subject to the alternative methodology, but add an AG-33 aggregate floor.
* Retain the RBC calculations as currently defined, modified for the changes to the tax law. By retaining these, this is a CTE90 value and therefore needs to be exempt from the 0.25 scalar.

Background:

When C3P2 was adopted in the summer of 2005, the methodology contained an Alternative Methodology for products with limited risks, defined to be death benefits only and no VAGLBs. When AG-43 was adopted in 2009, it contained a similar provision for the reserve calculation. The intention was to define a simpler method for reserve calculations where the complexity of a full stochastic model would provide limited if any benefits. As such, the scope of products was limited to product not containing a VAGLB.

When Oliver Wyman provided their Framework recommendations, the recommendations provided no explicit provision for the Alternative Methodology. In their redline draft of AG-43 provided as part of the December 1, 2017 proposals, the section on Alternative Methodology was not modified.

Rationale:

The primary focus of the Framework was to address volatility of reserves and RBC leading some companies to utilize captive insurance arrangements. That volatility also impacted company decisions on hedge programs and product design. The Alternative Methodology addressed a segment of the business that did not exhibit this type of volatility, nor was there material impact on hedge or other risk mitigation strategies – in short, the Alternative Methodology did not contribute to the problems and concerns that the Framework set out to address. As such, there is no compelling need to modify this part of the framework. Additionally, by retaining the current scenario generator for equity returns, the calibration of the calculation is not materially impacted by the recommended changes in the stochastic methods.

Standard Projection:

Within the new framework, the structure and scope of the standard projection has changed to focus on being a tool to help evaluate policyholder benefit assumptions, particularly those related to the lapse rates and benefit utilization impacting the guaranteed living benefits. Since products within the scope of the Alternative Methodology by definition do not have VAGLBs, it would serve little if any benefit for this group of policies to perform these calculations. In addition, the Standard Projection has been revised to rely on the stochastic model methodology. As companies that utilize the Alternative Methodology are doing so in part to avoid building the stochastic models, subjecting this business to the standard projection effectively voids any benefit of reduced model development from applying the alternative methodology. For these reasons, we believe that it is appropriate to exclude business valued by the Alternative Methodology from the requirements of the Standard Projection. With the absence of the standard scenario, it is appropriate to consider an AG-33 aggregate floor for the alternative method.

Risk Based Capital:

The discussion above for reserves would also apply to the Risk Based Capital calculations. The key difference here is the revisions to the federal income tax laws adopted in 2017, and the related modifications in the RBC instructions for 2018. Additionally, since the Alternative Methodology for RBC is calibrated to CTE90, the provision in the framework to apply a scalar to the difference between CTE98 and reserve would not apply to this group of contracts. Details will be provided as the RBC instructions are drafted.