VALUATION MANUAL (VM)-20 and Clearly Defined Hedging Strategy (CDHS) requirements

Amendment Proposal Form (APF) 2019-29 and general discussion

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Agenda

1 **Background**

2 **Proposed amendment**

3 **Considerations for CDHS requirements**

Background

Based on the success of Indexed Universal Life (IUL) many companies have added indexed account options to their Variable Universal Life (VUL) products

Indexed type crediting requires the use of hedging and to the extent a CDHS is used, these products are not eligible for exclusion from Stochastic Reserve (SR) and Deterministic Reserve (DR) requirements based on the following language in VM-20:

Stochastic Exclusion: Section 6.A.1.b

> "*A company may not exclude a group of policies for which there is one or more clearly defined hedging strategies from stochastic reserve requirements.*"

Deterministic Exclusion: Section 6.B.1.a

> "*…a group of policies that is not excluded from the stochastic reserve requirement is deemed to not pass the deterministic reserve exclusion test, and the deterministic reserve must be computed for this group of policies.*"

Proposed Amendment

The intent of Amendment Proposal Form (APF) 2019-29 is to allow a group of policies to be eligible for exclusion from SR requirements if a CDHS is used to support a non-material product feature (i.e., index account option with low utilization).

Without APF 2019-29, **features that don't require modeling** could cause groups of policies to be **exempt from exclusion testing** for modeled reserve requirements. Additionally, situations could arise where the **lack of a CDHS allows** a group of policies to be eligible for exclusion testing that would be ineligible if a CDHS were used.

Section 6.A.1.b (Proposed changes shown in red)

> "*A company may not exclude* ***from stochastic reserve requirements*** *a group of policies for which there is one or more clearly defined hedging strategies* ~~***from stochastic reserve requirements***~~ ***associated with a product feature to be modeled pursuant to Section 7.B.1.***"

Section 7.B.1 (referenced in the proposed language) sets requirements for the projection of cashflows reflecting "the effect of all material product features."

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Considerations for CDHS requirements

1. VM-20 requirements prohibit projecting hedging transactions that aren't associated with a qualifying CDHS.

2. This prohibition was added to address concerns that reserves could be unduly reduced by including programs that might not be executed.

3. Life writers are incentivized to hedge indexed deposits due to high capital charges and risk introduced if deposits were not hedged (i.e., backed with equities or general account assets).

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Questions?

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