Ken Christy

Assistant Actuary

763.765.4147

Ken.Christy@allianzlife.com

To: Mr. Mike Boerner, Chair, NAIC Life Actuarial Task Force (LATF)

06.11.2021

Regarding: Comments on APF 2020-12

Dear Mr. Boerner,

**Executive Summary**

Thank you for the opportunity to review and share feedback on the proposed changes to APF 2020-12. The collaboration between companies and regulators that we have in the insurance industry is extremely valuable.

I recognize that regulators are concerned with the optionality of including hedging cash flows within the principle-based framework. My understanding of the concern is that regulators want to have confidence that reserves are sufficient, but that can be challenging for a regulator to assess if a certain category of cash flows is excluded.

I understand and appreciate the goal, but I am concerned with the application as written in APF 2020-12. The Valuation Manual does not seem to address the difference in nature between long-term guarantee hedging vs. short-term index-credit hedging. The APF increases the scope of hedges included in the principles-based framework and pushes all hedging programs into a one-size-fits-all approach. The one-size-fits-all approach has some shortcomings when it is applied to index credit hedges. While these concerns exist with or without the adoption of APF 2020-12, the concerns are exaggerated by the proposed changes.

Some concerns with the proposed framework are: the VM-21 Adjusted run is not a good fit for index credit hedges, the VM-20 Stochastic Exclusion Test verbiage does not reflect the relatively lower risk in index credit hedges, and each of these concerns would be inappropriate to be used as precedent for VM-22 in the future.

**VM-21 – Adjusted Run**

My first concern is the application of the VM-21 adjusted run to index credit hedges. The Adjusted vs Best-Efforts runs are a good fit for long-term guarantees because there is often no dynamic interaction between the guarantees and the hedge that supports them. In the example of a GMDB, the company’s responsibility for policyholder benefits is identical with or without a hedge. The guarantee is explicitly stated in the contract.

On the other hand, the crediting strategies offered on Registered Index-Linked Annuities (RILAs) have non-guaranteed elements (NGEs) – crediting caps, crediting floors, negative credit buffers, etc. – that are dependent on the company’s ability to hedge. The crediting features offered by the company are different if a hedge is not in place, which would alter cash flows used in the reserve calculation. Modeling this alternate world in which a hedge does not exist does not provide a meaningful result for the company nor regulator.

It seems most appropriate that RILAs with a CDHS should only utilize the Best Efforts calculation for index-credit hedges due to the inappropriateness of separating the hedge from the liability cash flows.

**VM-20 – Stochastic Exclusion Test**

My second concern is that this change will limit the eligibility of companies to utilize the Stochastic Exclusion Test. The availability of the exclusion tests is to allow products that do not have significant exposure to equity and interest rate risks to limit the procedural complexity of the reserving process. The existence of a CDHS or SHS does not inherently mean that a company has significant equity or interest rate risk impacting their future solvency. Indexed crediting features are enhanced by the company’s ability to hedge. If the company could not hedge, crediting features may be different to reflect the assets supporting the benefits. Ultimately the contract guarantees determine a company’s risk exposure, not simply the existence of a hedge.

The existence of a hedge should not be preclude a product from Exclusion Tests.

**Alternate Path**

The current version of APF 2020-12 should not be adopted without adjusting for the different nature between short-term index credit hedges, which can be very tightly matched, and long-term guarantee-focused hedges, which have more risk of mis-estimation. I recommend an additional hedge category (in addition to CDHS & SHS) that only utilizes best-efforts runs and qualifies for Exclusion Tests. This category can be defined as hedges supporting benefits with non-guaranteed elements.

Sincerely,

Ken Christy, Assistant Actuary

Allianz Life Insurance Company of North America