February 4, 2022

Mr. Fred Andersen
Chair, NAIC Indexed Universal Life (IUL) Illustration (A) Subgroup

Re: IUL Exposure

Mr. Andersen,

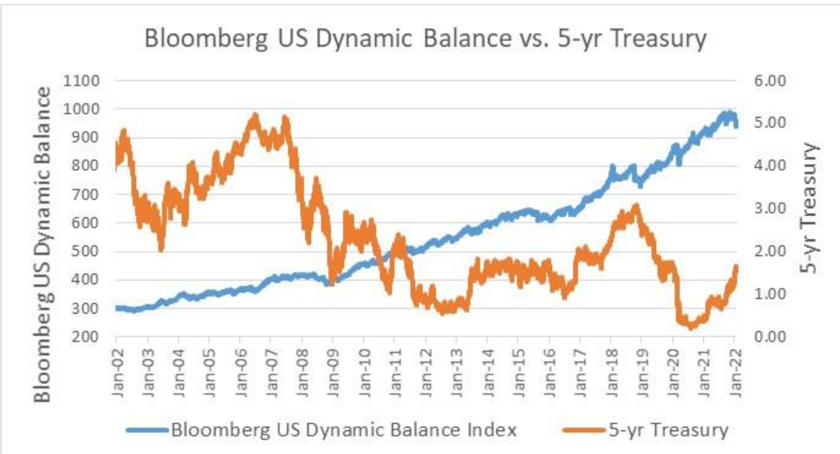
Allianz appreciates the opportunity to provide comments on the matters discussed in the LATF IUL Exposure from December, 2021. Allianz offers a variety of allocations with various crediting methods and indexes to consumers. When the cost of hedging any given allocation changes, it is possible to have better historical performance than the S&P500 at a lower cost. In these cases, a company can decide what they would like to do with this excess hedge budget and what the consumer may find most valuable, whether it be higher caps/rates, fixed bonuses, lower charges, or other unique features. The decision on where to provide additional value occurs across all allocations, whether or not they are a Volatility Control Index (VCI). When there are situations where hedging costs are lower and the allocation provides historical outperformance compared to the S&P500, we think it is valuable to the consumer to reflect the additional affordable benefits that are offered within the current restrictions of AG 49-A. Because VCIs are specifically highlighted in the LATF letter and Allianz has offered VCIs for over 8 years, we wanted to provide our perspective on the consumer value of VCIs.

Allianz History
Allianz began offering allocations tied to VCIs on its Fixed Index Annuity (FIA) and IUL products in 2013 and 2014 respectively. The benefits of offering an index with a volatility control mechanism include diversification, stability in rate renewal, stability in and strong credit performance, and unique benefits only available with VCIs. Because of these benefits, allocations tied to VCIs offer and have delivered unique value to our policyholders and they are an important part of our index line-up.

VCIs are indexes that have some type of mechanism to control volatility. This mechanism can range from a defined formulaic approach, to active management, to something in between. The VCIs that Allianz offers on our IUL products use a defined formula that rebalances between an equity component and fixed income/cash components on a daily basis. The purpose of this daily rebalancing is to hit a specific volatility target, thus controlling the volatility of the index. Generally speaking, equities are more volatile than fixed income, so the indexes will allocate more heavily to equity in times of low volatility and more heavily to fixed income in times of high volatility.

Benefits of Volatility Controlled Indexes
<u>Diversification</u>
The combination of equity and fixed income can provide a diversification benefit and the VCIs we offer have both equity and fixed income components, leading to more diversification than a standard equity only index. VCI performance can benefit when either equity or fixed income does well, or if one of the components does not perform well, the other component can offset that low performance and allow the policyholder to still get a credit. This allows the policyholder to experience positive results in many different market environments, not only when the equity market is strong.

Diversification through fixed income can bring risks, and a common question raised about VCIs is will their high allocation to fixed income lead to underperformance in rising interest rate environments and is their good historical performance due to decreasing interest rates over the last 20 years. It is true that fixed income allocations will likely underperform when interest rates rise, but because of the diversification VCIs offer, the overall impact on long term performance of the VCI will vary based on **all** components of the index, including the equity component. The chart below compares the relationship of interest rates with the performance of the first VCI we offered, the Bloomberg US Dynamic Balance Index over the last 20 years.



Note: The Bloomberg US Dynamic Balance Index has been active since 2013, index performance before that is based on the underlying components of the index and the prescribed formula used to balance between the components.

While the general trend in rates has been down over the last 20 years, there have been several periods of sustained rate increases or rate spikes, like 2003-2006, 2009, 2017-2018, or 2021. The performance of the Bloomberg US Dynamic Balance Index during those periods is mixed, some really good, some moderate, and some flat. This is because market volatility and the performance of the equity component are material considerations of the VCI performance. In fact, over the last 10 years, interest rates have risen slightly and the performance of the index has been strong, mainly due to lower volatility and strong equity performance.

Because of the diversification offered by VCIs, the performance of the index is also able to weather equity market downturns, like the ones in 2002, 2008/2009, 2018, and 2020. The graph above shows that the VCI did not suffer large losses during those periods. This was due to the volatility control mechanism allocating away from equities when volatility spiked during the market downturns, further enhancing the benefits of diversification of the VCI.

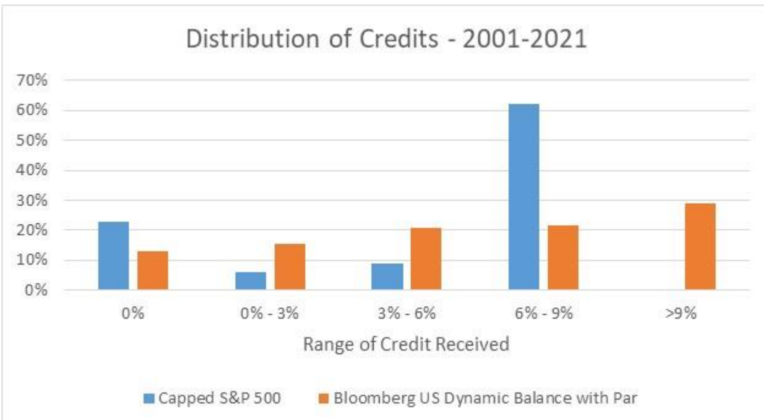
Stable Rate Renewal

Volatility is a key driver of hedging costs and market volatility can fluctuate greatly from year-to-year. For a capped S&P500 allocation, changes in market volatility will lead to changes in hedging costs and therefore changes in the offered cap. This can lead to large changes in caps on a year-to-year basis and large changes in the historical lookback used for setting maximum illustrated rates in AG49. By contrast, VCIs target a stable volatility, leading to more stable option costs and therefore more stable affordable participation rates. On a year-to-year basis, the policyholder is less likely to experience large changes in participation rates and large changes in the AG49 lookback. This provides the policyholder a more stable and predictable experience over the life of their contract and creates historical lookbacks that rely less on current market conditions and are more representative of what would have actually been experienced over the historical period.

Stable and Strong Credit Performance

The VCIs we offer target a low and controlled volatility, so the index will increase and decrease more slowly than a higher volatility index, like an equity index. More stable index values lead to more stable credits, which is a benefit for IUL policyholders where product fees are present and timing of high or low credits can impact long term policy performance. Stable credits also better align with IUL illustrations, which do not show the variability of index performance.

The higher stability in credits a VCI can achieve is illustrated below by comparing the distribution of historical performance over the last 20 years between the Bloomberg US Dynamic Balance Index allocation and our capped S&P500 allocation. The analysis uses currently offered caps and participation rates and it can be seen that the distribution of the Bloomberg US Dynamic Balance Index credits are more evenly distributed than the S&P500 credits, which are more barbell shaped and have more instances where the policyholder does not receive a credit.



Note: The Bloomberg US Dynamic Balance Index has been active since 2013, index performance before that is based on the underlying components of the index and the prescribed formula used to balance between the components.

What can also be seen in the analysis above is that Bloomberg US Dynamic Balance Index allocation offers more potential upside than the capped S&P500 allocation. This strong historical performance is seen in the differences in historical lookbacks between the VCI allocations we offer and the capped S&P500, with the VCI allocations outperforming the S&P500 allocation by 2-3% on average.

Allianz started offering allocations tied to the Bloomberg US Dynamic Balance Index on our IUL policies in 2014, so in addition to strong historical lookback performance, we have 7 full years of credits that have been realized by our policyholders. Over that time, our allocation to this VCI has averaged 1.25% higher credits per year than the S&P500 allocation and both of the allocations have performed above the AG49 maximum allowed illustrated credit.

Average Realized Credits 2015-2022		**AG49 Maximum Illustration Limit**	
Capped S&P500	**Bloomberg US Dynamic Balance with Par Rate**	**Average Limit 2015-2022**	**Current Limit**
6.77%	8.02%	6.18%	5.50%

Note: The analysis above assumes a 1/1/2015 contract issue date, with the version of our IUL product available at that time

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Unique Benefits Available to VCIs

The composition of the VCIs we offer allow us to offer unique benefits to our policyholders. Hedging for the VCIs we offer currently cost less than options for S&P500. We are able to take the hedging savings and offer a variety of benefits for the policyholder to choose from, including higher participation rates, a multiplier bonus, or a fixed bonus, all with a unique lock feature on top of these other benefits.

Our lock feature allows a policyholder to “lock-in” their index performance at any point during their crediting period instead of waiting until their policy anniversary, giving the policyholder a level of control over their policy that they cannot get with any other index. We have seen tremendous interest in this benefit since we introduced it in 2019 and we are only able to offer it because of the stable option costs for VCIs.

Summary

Allianz has offered allocations tied to VCIs since 2013. Our policyholders that have allocated to these indexes have benefited from diversification, stability in renewal rates, stability in and strong credit performance, and features like Index Lock. These policyholders have realized credits that exceed our S&P500 allocations and have been the recipients of additional benefits because of the lower and more stable option costs associated with the VCIs. The VCIs we offer and the additional benefits tied to them make up an important part of our product offering and give our policyholders valuable choice in their allocations. In order to have a fully informed and educated consumer when selecting their allocation choice, we feel that the additional benefits and value VCIs provide should be reflected while still adhering to the current AG 49-A illustration restrictions.

Thank you for the opportunity to provide these comments.

Regards,

Austin Bichler, FSA, MAAA
AVP Actuary & Illustration Actuary
Allianz Life Insurance Company of North America