

August 25, 2020

Mr. Mike Boerner, Chairperson, Life Actuarial (A) Task Force (LATF)
National Association of Insurance Commissioners

Re: Model Law #805 Exposure

Mr. Boerner,

Thank you for the opportunity to provide comment on the Model Law #805 exposure. Allianz Life has been a top provider of fixed index annuities over the past 20 years and has offered innovative lifetime income benefits since 2006. As part of Allianz Group, we also have extensive experience providing insurance solutions in low or negative rate environments across the globe.

We urge regulators to act swiftly to decrease the nonforfeiture interest rate floor to 0%, because the current 1% floor may result in greater investment risk and reduced policyholder benefits.

Annuity Nonforfeiture Background

At policy issue, the minimum nonforfeiture value is equal to 87.5% of premium. This amount is less than 100% because the insurer has upfront cash flow needs such as capital requirements, acquisition expenses, and advisor compensation. It also protects the insurer if the policy is surrendered before these expenses have been recouped.

The minimum nonforfeiture value earns interest at a rate equal to the five-year treasury yield less a 1.25% reduction and an additional equity index offset of 1% (if applicable). The five-year treasury is used because it provides a conservative proxy for the investments that back a typical annuity. The 1.25% reduction accounts for expenses associated with the policy as well as additional benefits such as bonuses, death benefits, or lifetime income. The 1% equity index offset recognizes that a portion of the interest earned by the insurer is used to purchase hedging instruments and thus reduces the interest that can be guaranteed in the policy, since the hedging instruments may lose their value.

We believe this framework has functioned well because it guarantees value to the policyholder while protecting the insurer from the risks associated with issuing an annuity policy. However, the 1% interest rate floor is unsupportable in today's low interest rate environment.

Impact of the 1% Interest Rate Floor

Annuities are long-term retirement vehicles that are backed by high quality, long-term assets. Long-term assets are used because they provide an asset/liability match and generally provide consumer value because long-term assets typically have higher yields than short-term assets.¹

If the nonforfeiture interest rate is too high, insurers may need to invest in riskier, less liquid and/or more complex assets to provide benefits and support guarantees. In certain economic scenarios, this could put stress on insurers' ability to pay claims.

In addition, when the nonforfeiture interest rate is too high, insurers may need to decrease other policy benefits in order to support the nonforfeiture value. For example, annuities with lifetime income benefits may offer lower income amounts as a result of the higher nonforfeiture value.

¹ Even in today's low interest rate environment, the ten-year treasury yield is five times higher than the one-year treasury yield (0.55% vs. 0.11% on 7/31/2020).

Allianz Life supports a 0% Interest Rate Floor

On 7/31/2020, the five-year treasury rate was at an all-time low of 0.21%. The Federal Reserve has indicated that rates are unlikely to increase through 2022.² The forward curve also implies that rates will remain low for a long time.³ Thus, this issue is not likely to be resolved anytime soon.

Low risk-free rates and credit spreads make it increasingly difficult to support consumer benefits, including nonforfeiture values, using traditional investment methods. We support a 0% floor because it would reduce the need for insurers to increase investment risk to meet minimum nonforfeiture guarantees and allow insurers to provide greater benefits elsewhere in the product.

In the current interest rate environment as of 7/31/2020, the difference between a 1% floor and a 0% floor equates to a difference of approximately 25% to 35% of annual guaranteed income in our fixed indexed annuity policies, assuming the same investment risk and profitability targets. In a \$100,000 policy, that difference is approximately \$750 to \$1,250 every year during income payout.

In conclusion, we urge regulators to act swiftly to decrease the nonforfeiture interest rate floor to 0%, because the current 1% floor may result in greater investment risk and reduced policyholder benefits.

Thank you for the opportunity to provide these comments.

Regards,



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² <https://www.federalreserve.gov/monetarypolicy/fomcproptabl20200610.htm> (Federal Funds Rate projection).

³ As of 7/31/2020, the thirty-year treasury yield was 1.20%, which indicates that over the next thirty years, the average rate of return is expected to be 1.20%.