

Variable annuities: bridging the divide

Paul Shallis, KPMG and Mark Hills, Sun Life Financial of Canada



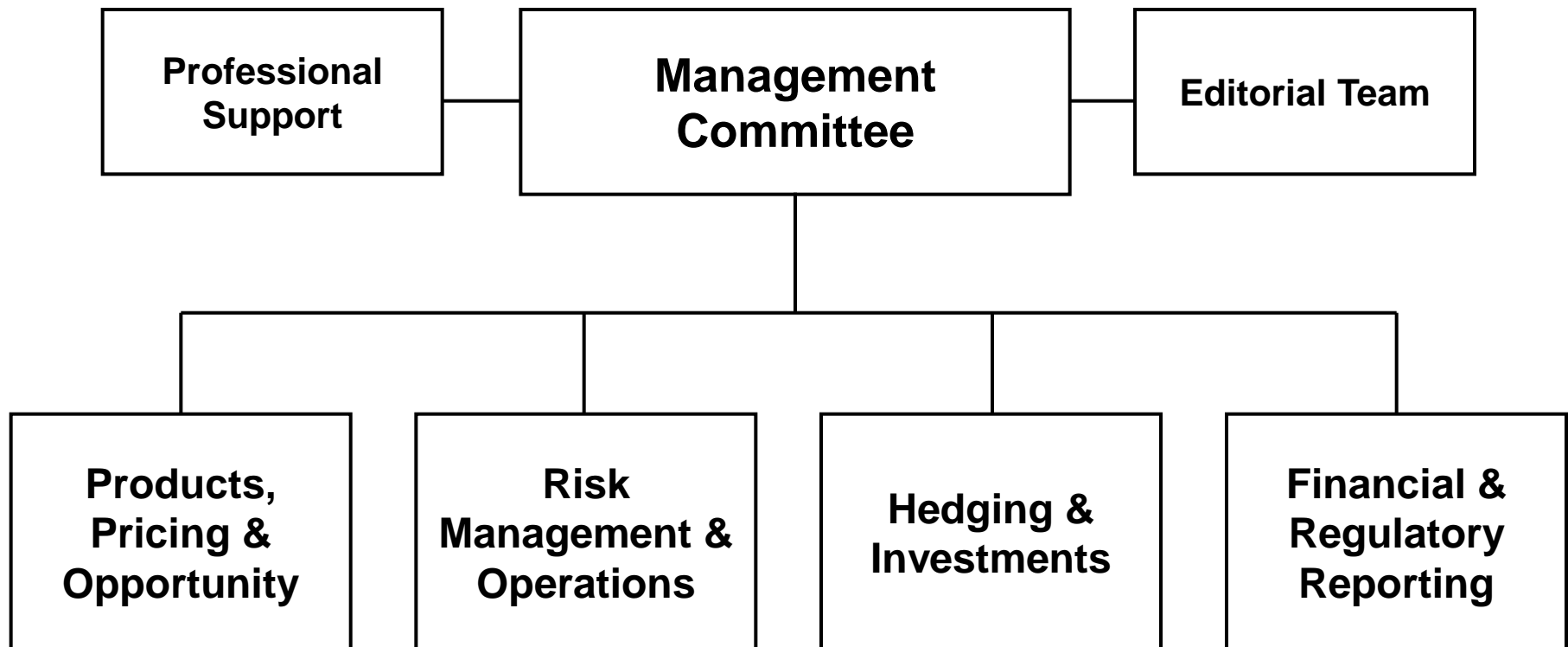
Product developments Past, Present and Perfect?

17 September 2010

Variable annuity member interest group

- Established and operates under the wing of ERM practice area
- Founder members assembled from working parties preparing materials for conventions
- Mission Statement
- “an interactive community for the discussion and exchange of comment and research relevant to the product area generally known as Variable Annuities “
- Website
 - http://www.actuaries.org.uk/members/migs/topical_migs/variable_annuities_members_interest_group

Variable annuity member interest group

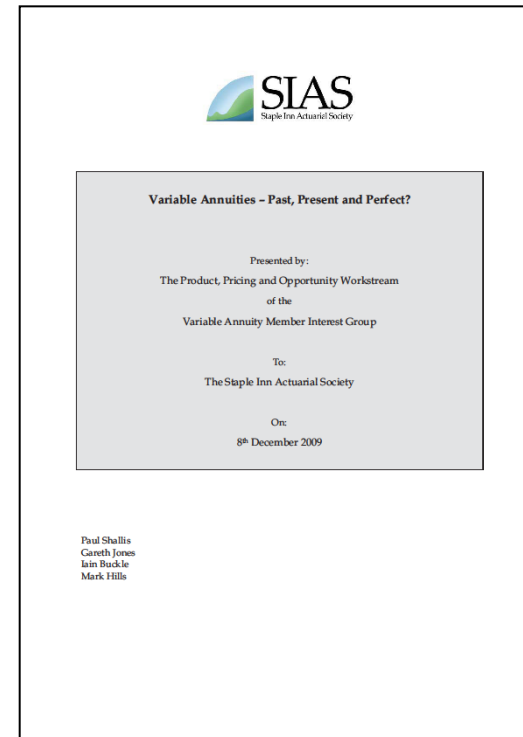


Products, pricing and opportunity – terms of reference

- To consider the on-going evolution of the variable annuities market in the UK, covering such areas as
 - The products being developed
 - The nature and pricing of guarantees
 - Interaction with the UK tax regime
 - Drivers of and obstacles to sale
 - Future market trends

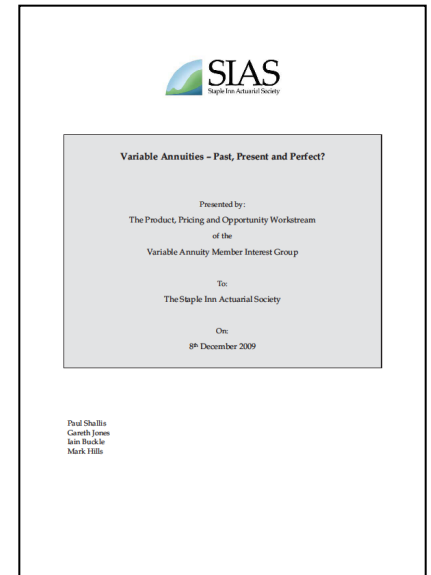
Products, pricing and opportunity – outputs

- Life convention, Edinburgh – November 2009
- SIAS paper – December 2009
- VA survey – August 2010

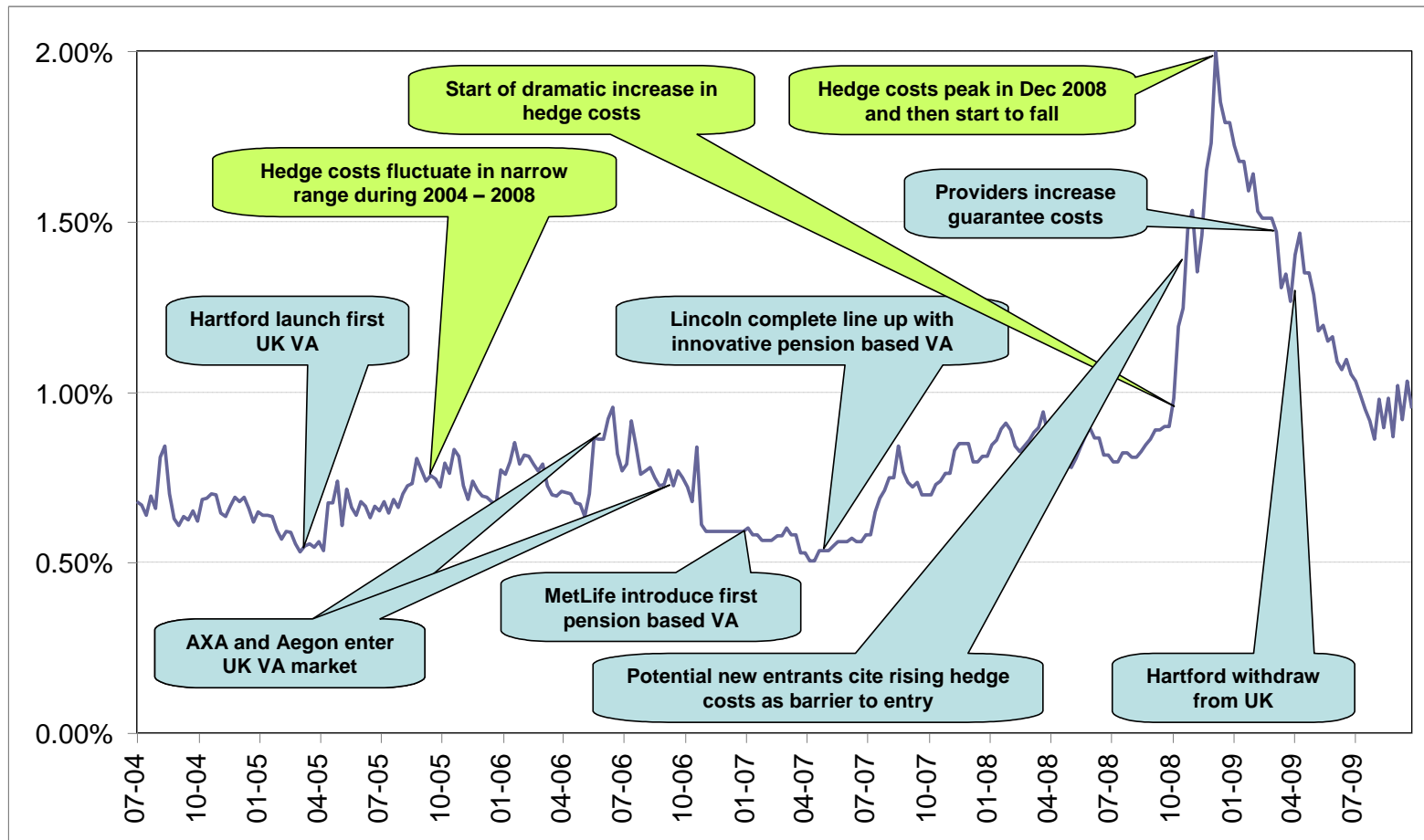


VA – Past, Present and Perfect?

- Unlike previous UK papers, *Past, Present and Perfect?* focuses on consumers and advisers, rather than technical aspects
- Structure of paper:
 - Introduction
 - Brief history – what happened in 2009?
 - Customer need – is there one and, if so, what is it?
 - The future – what will drive it?
 - The future – what might happen?



Brief history – UK hedge index



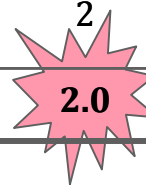
- Source (UK Hedge Index): Milliman (cost of 5% GMWB, 3-yearly ratchets for male 65, 60% UK equity 40% bond)

Customer need – does VA play a role?

- Compared 4 products – VA, level & escalating annuity and income drawdown
- Based on industry data, surveys, FSA tables, but still some subjectivity
- Identified 5 possible desired outcomes
 - Starting level of income
 - Potential for increasing income
 - Protection against failing income
 - Inflation mitigation
 - Death benefits

Customer 1: equal weightings

	Level Annuity	Escalating Annuity	Income Drawdown	Variable Annuity	Weight
Starting Level of Income	2	3	1	4	20%
Potential for Increasing Income	4	3	1	2	20%
Protection against Falling Income	1	2=	4	2=	20%
Inflation Mitigation	4	1	2	3	20%
Death Benefits	3=	3=	2	1	20%
Average	2.8	2.4	2.0	2.4	100%



Customer 2: maximise income, can't afford a fall

	Level Annuity	Escalating Annuity	Income Drawdown	Variable Annuity	Weight
Starting Level of Income	2	3	1	4	50%
Potential for Increasing Income	4	3	1	2	10%
Protection against Falling Income	1	2=	4	2=	40%
Inflation Mitigation	4	1	2	3	0%
Death Benefits	3=	3=	2	1	0%
Average	1.8	2.6	2.2	3.0	100%



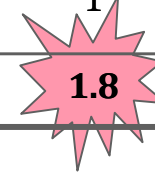
Customer 3: doesn't need highest initial income

	Level Annuity	Escalating Annuity	Income Drawdown	Variable Annuity	Weight
Starting Level of Income	2	3	1	4	10%
Potential for Increasing Income	4	3	1	2	20%
Protection against Falling Income	1	2=	4	2=	50%
Inflation Mitigation	4	1	2	3	20%
Death Benefits	3=	3=	2	1	0%
Average	2.3	2.1	2.7	2.4	100%



Customer 4: pass on wealth, death benefits key

	Level Annuity	Escalating Annuity	Income Drawdown	Variable Annuity	Weight
Starting Level of Income	2	3	1	4	5%
Potential for Increasing Income	4	3	1	2	10%
Protection against Falling Income	1	2=	4	2=	40%
Inflation Mitigation	4	1	2	3	5%
Death Benefits	3=	3=	2	1	40%
Average	2.3	2.5	2.7	1.8	100%



Customer need – summary

- Customer 1 – Income Drawdown
- Customer 2 – Level Annuity
- Customer 3 – Escalating Annuity
- Customer 4 – VA

What will drive the future?

Supply	Demand
Regulatory	Regulatory
Economic	Demographic
Market	Awareness

Scenario 1 – “Flash in the pan”

Regulatory

Pension Regs remain prescriptive

Solvency II increases capital reqs for VA

RDR reduces advice availability

Economic

High vol, low rates keep gtee costs up

Illiquidity hits key hedge markets

Demographic

Flexible Retirements don't take hold

Life expectancy improvements slow

Awareness

Conventional Annuities still dominate

Complex product confuses consumers

Market

Market remains fragmented

No new entrants

Further withdrawals?

Remains IFA only sale

Scenario 2 – “Take-off”

Regulatory

Solvency II impacts conventional annuities

FSA complete review of guaranteed products, confidence improves

Pension Regs liberalise

Economic

Innovation of hedge instruments

Markets calm, guarantee costs down

Hedge markets liquid

Demographic

DC monies drive need to ‘up-risk’

DC monies demand innovation

Awareness

Guarantee value communications improve

High Street distribution starts

“Simple VA” takes off

Market

Products standardise

Current players remain committed

Range of new entrants in market

VA – Past, Present and Perfect?



Variable Annuities – Past, Present and Perfect?

Presented by:
The Product, Pricing and Opportunity Workstream
of the
Variable Annuity Member Interest Group

To:
The Staple Inn Actuarial Society

On:
8th December 2009

Paul Shallis
Gareth Jones
Iain Buckle
Mark Hills

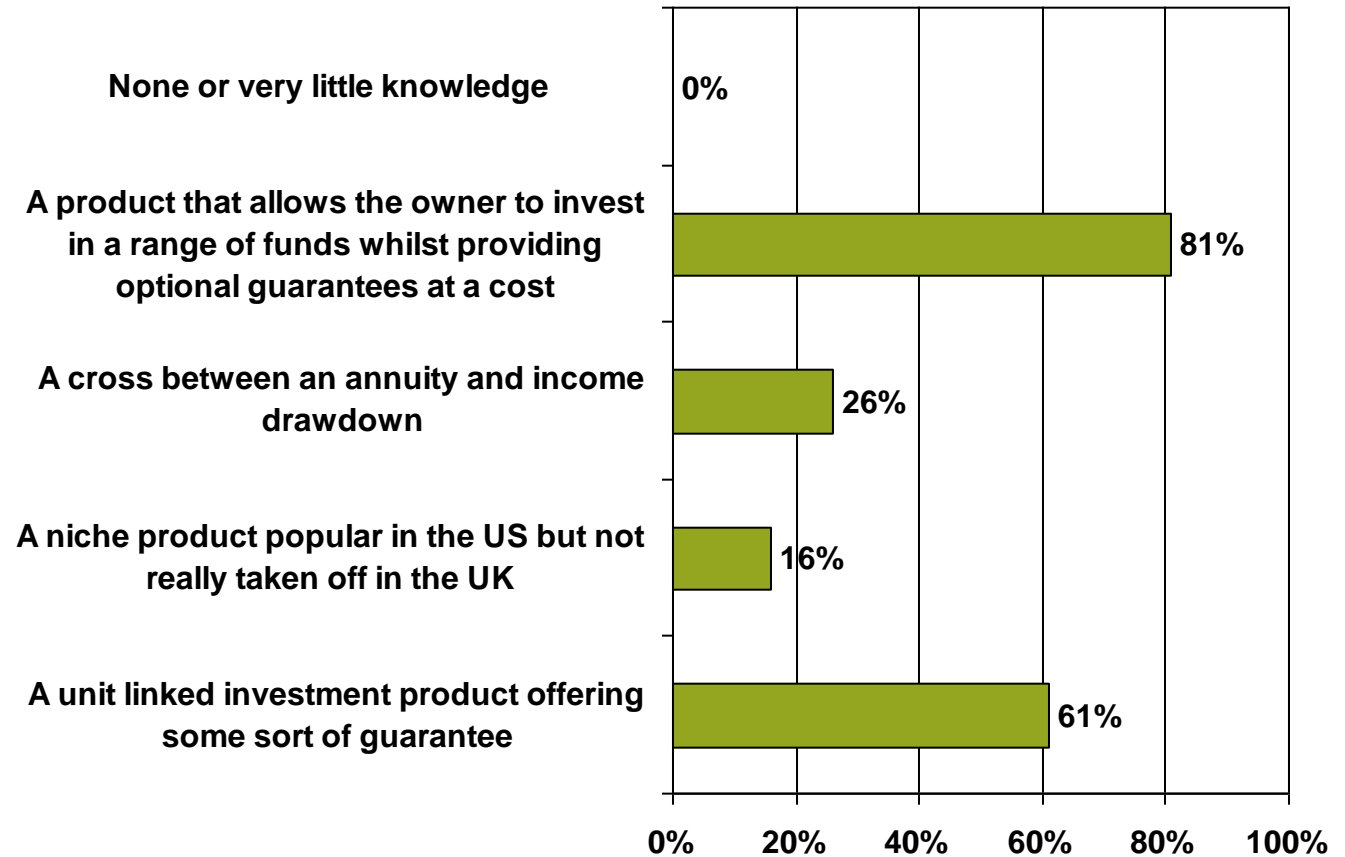
- http://www.sias.org.uk/siaspapers/listofpapers/view_paper?id=VAPastPresentandPerfect

VA provider survey

- Survey of views of actual and potential VA providers carried out by VA MIG in August 2010
- Survey issued to all members of VA MIG
- 31 responses received
- Survey covered:
 - Market opportunity
 - Market entry
 - Product design and pricing
 - Risk management
 - The future

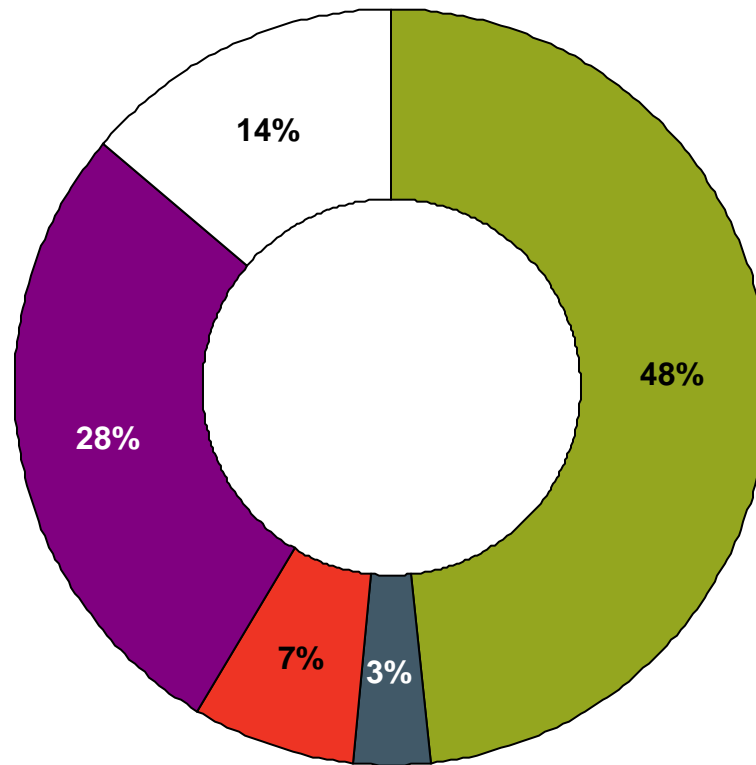
General

1. Please tick up to two statements that you feel best describe your understanding of a variable annuity product



General

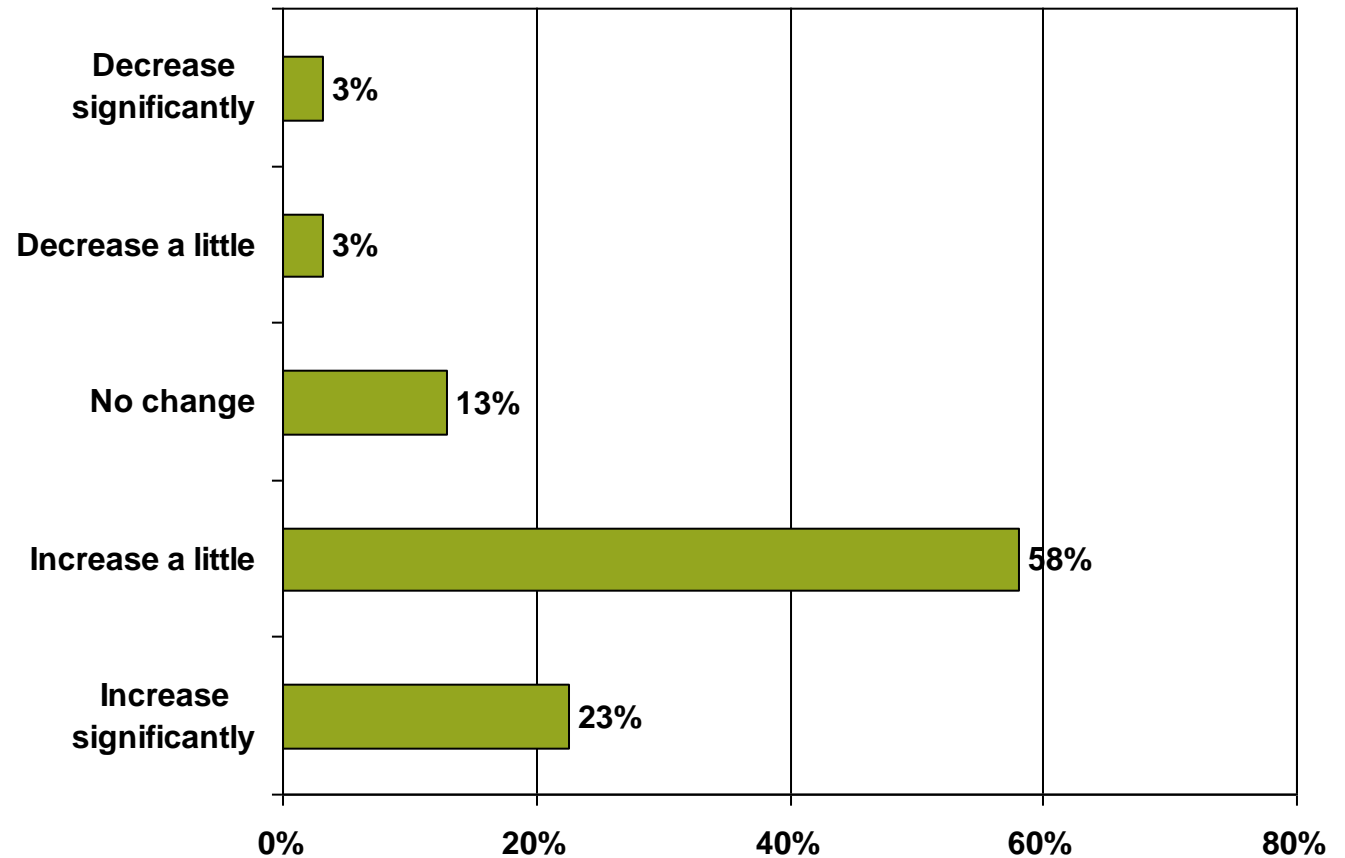
2. Which of the following applies to your company in respect of the VA market? Please tick one



- Already have one or more products
- Have a first product in development
- Is currently considering entering
- Have considered entering but decided against
- Have not considering entering

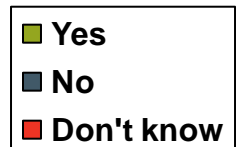
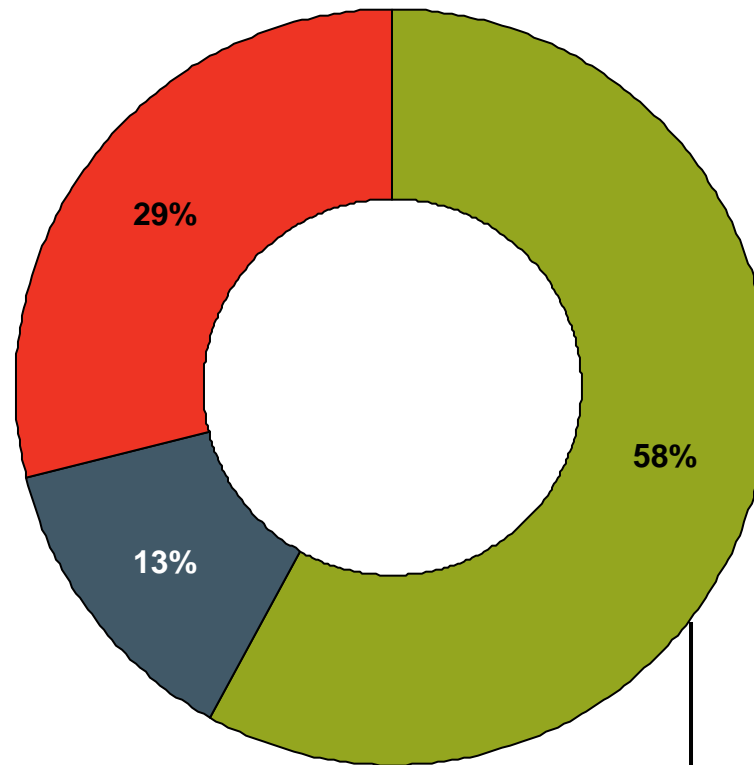
Market opportunity

3. What are your views on the prospects for variable annuities as a product class over the next 3 years? Please tick one



Market opportunity

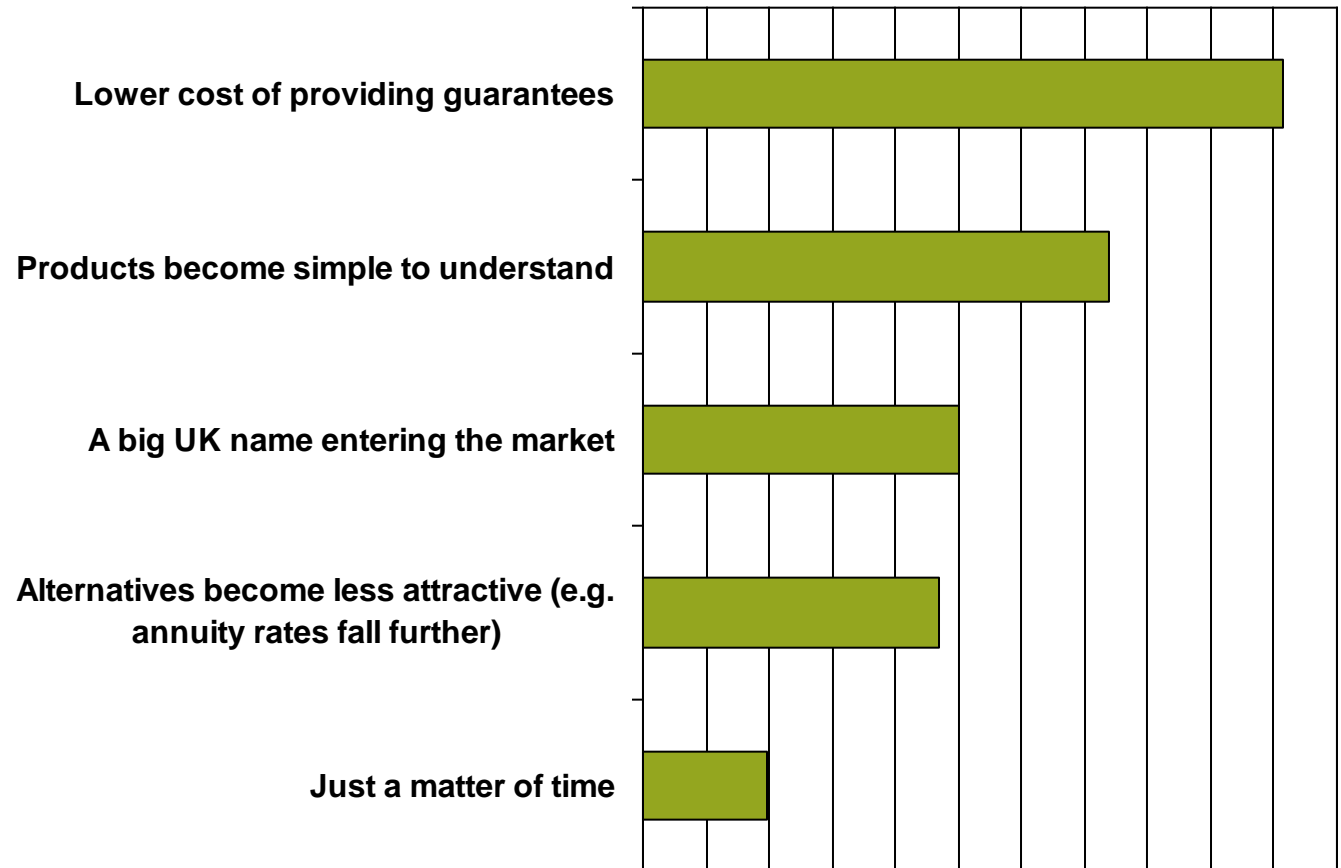
4. Do you see other providers entering the market in 2010/11? If yes, who?



Aviva
AXA
European companies
LV=
Prudential
Standard Life
Zurich

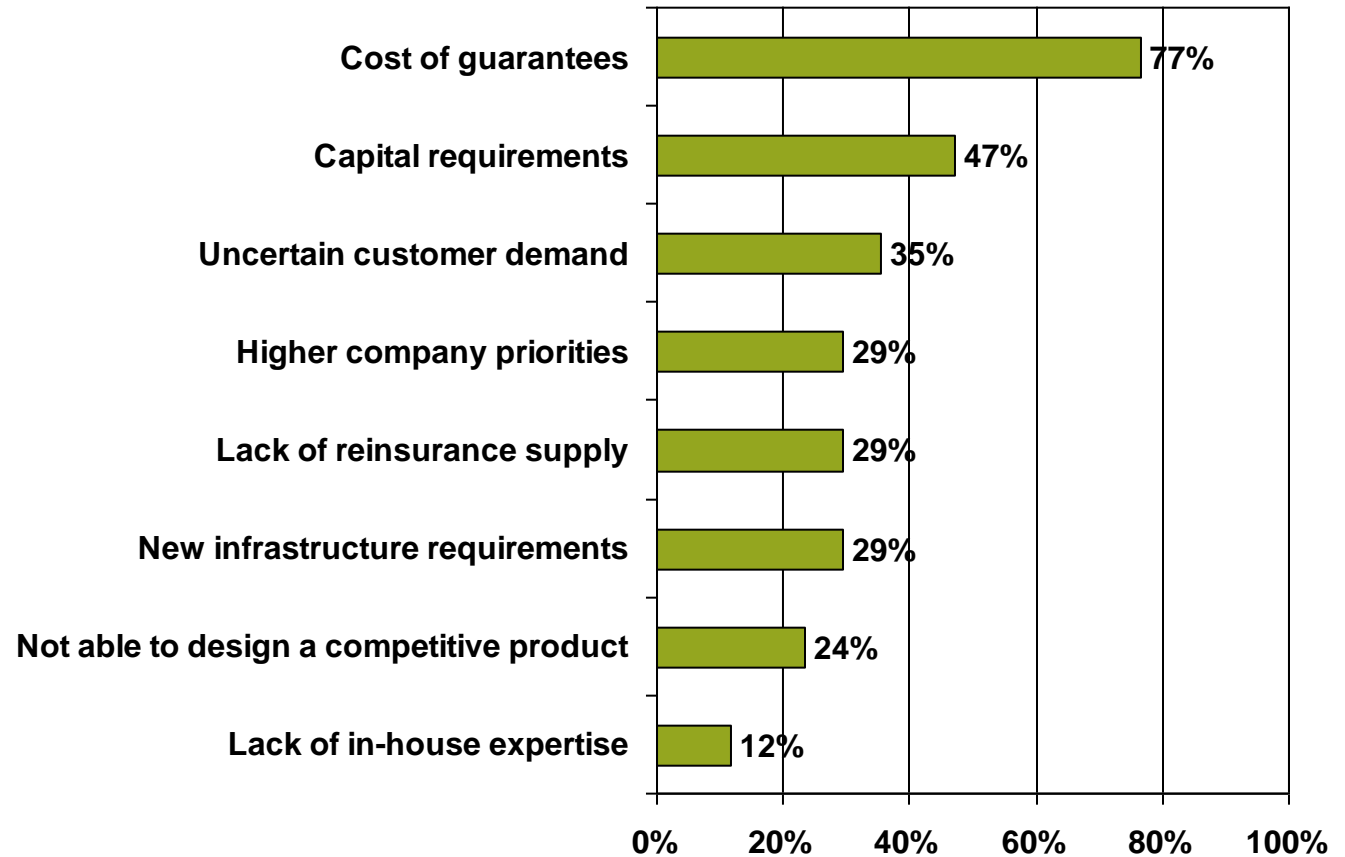
Market opportunity

5. What do you believe are the main barriers to overcome before variable annuities become a mass market product? Please rank top 3 (rankings shown reflect combination of all responses)



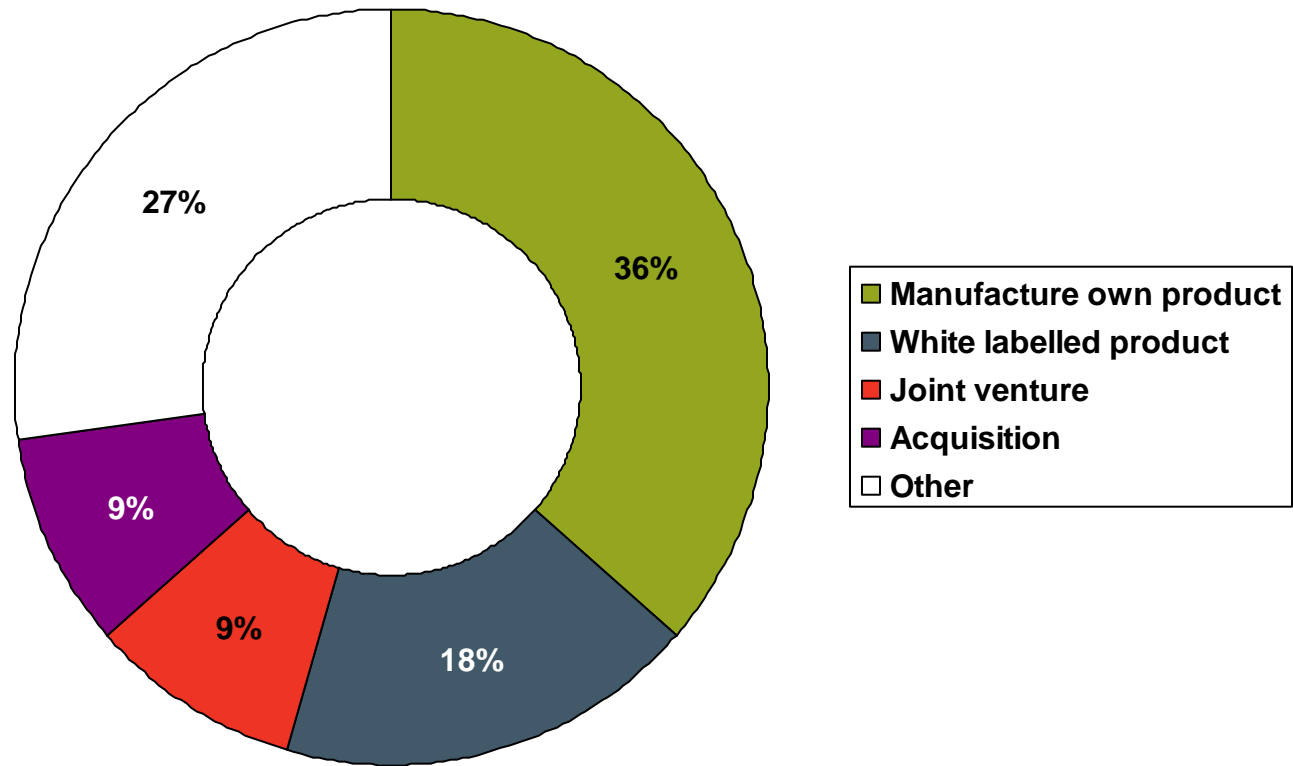
Market entry

6. If you have considered entering the VA market but have not yet done so, what is the reason(s)? Please tick all that apply



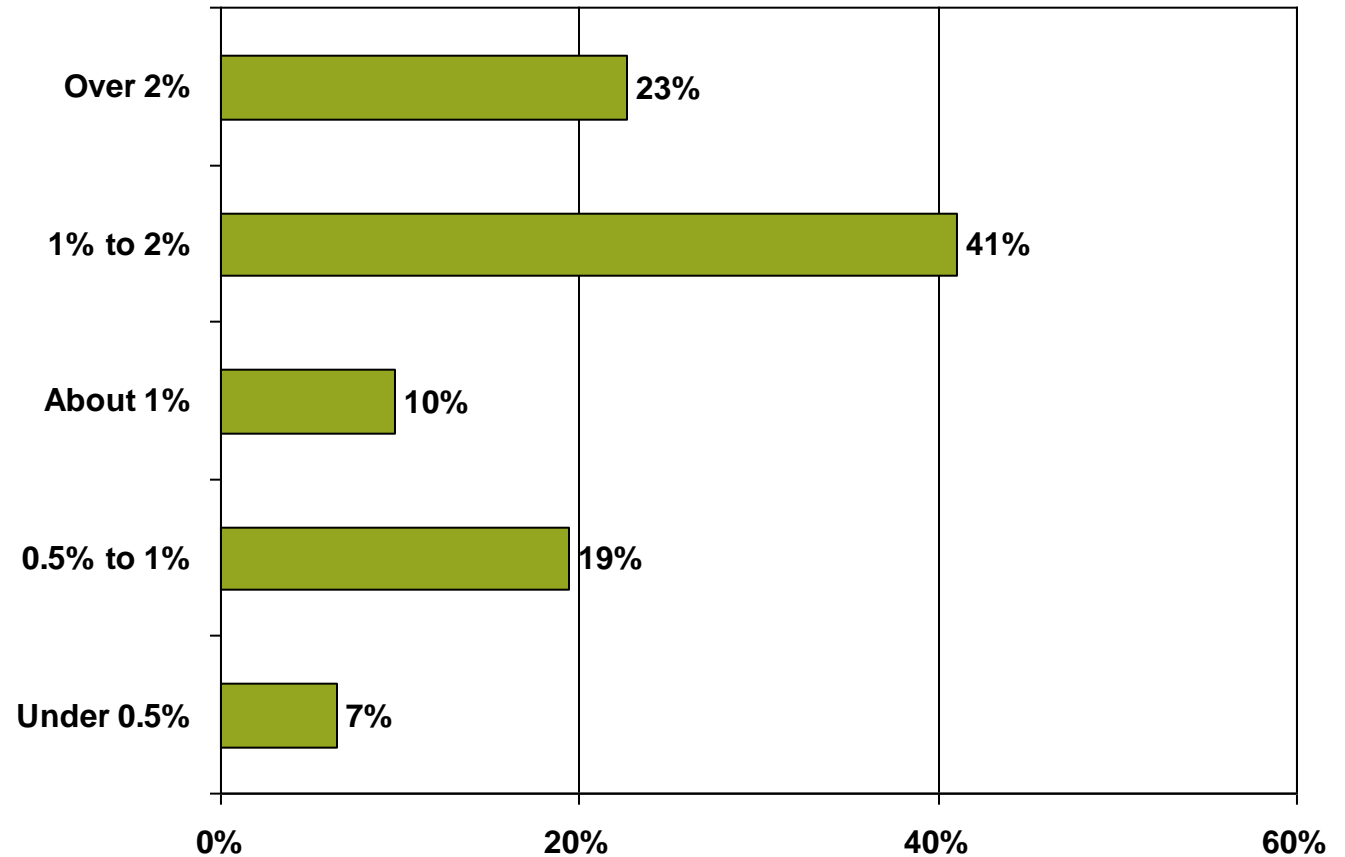
Market entry

7. If you are currently considering entering the market, what is your preferred entry strategy?



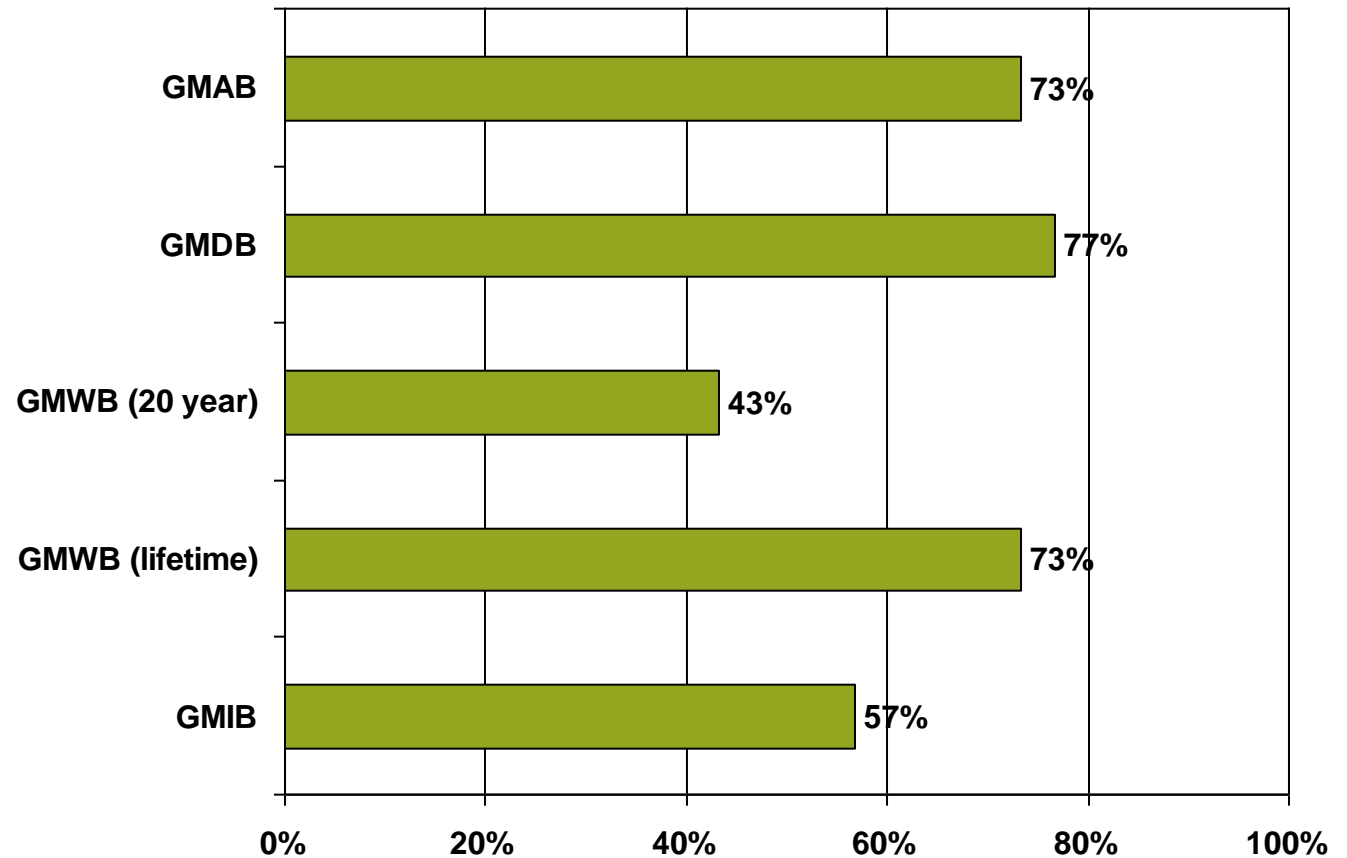
Product design and pricing

8. Consider a typical VA product (life aged 60 with lifetime income guarantee invested in managed fund with 60% equity). What do you consider would be the maximum annual charge just for providing the guarantee that you would be prepared to pass on?



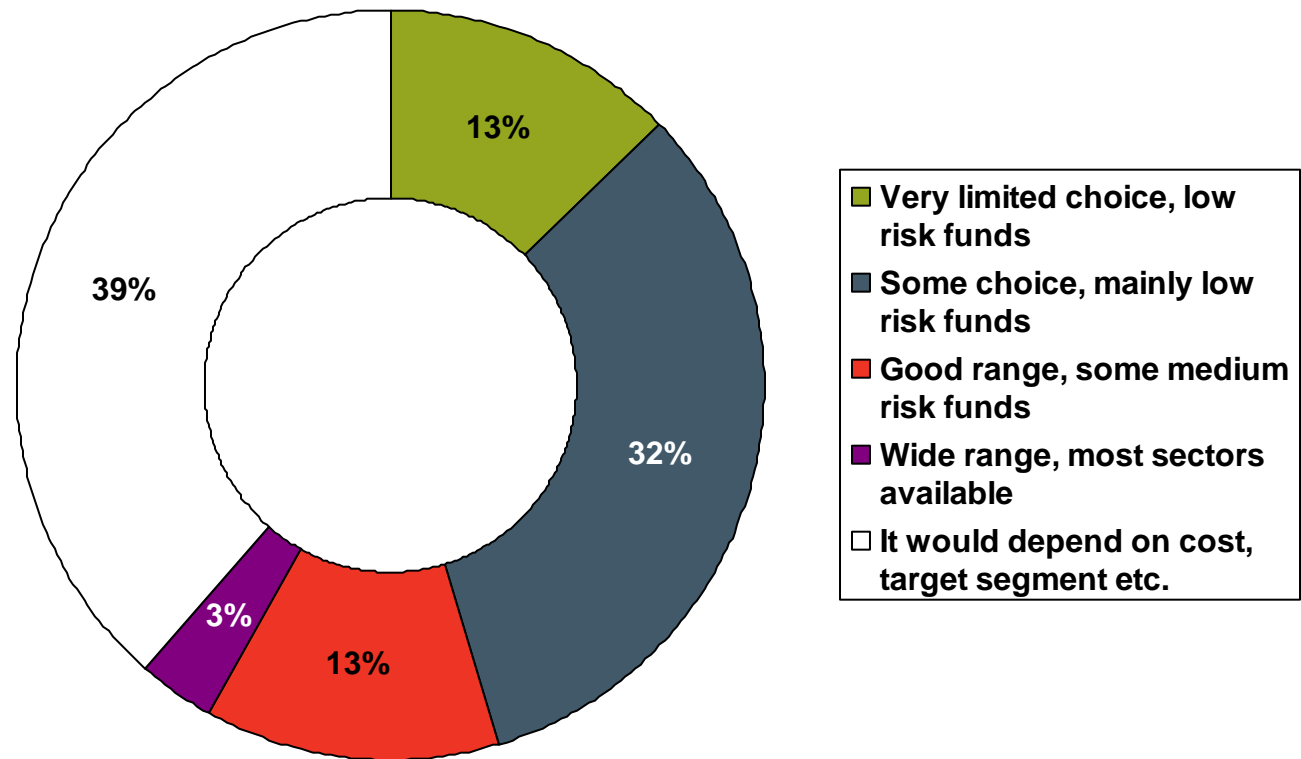
Product design and pricing

9. What types of VA guarantee would you consider selling?
Please tick all that apply



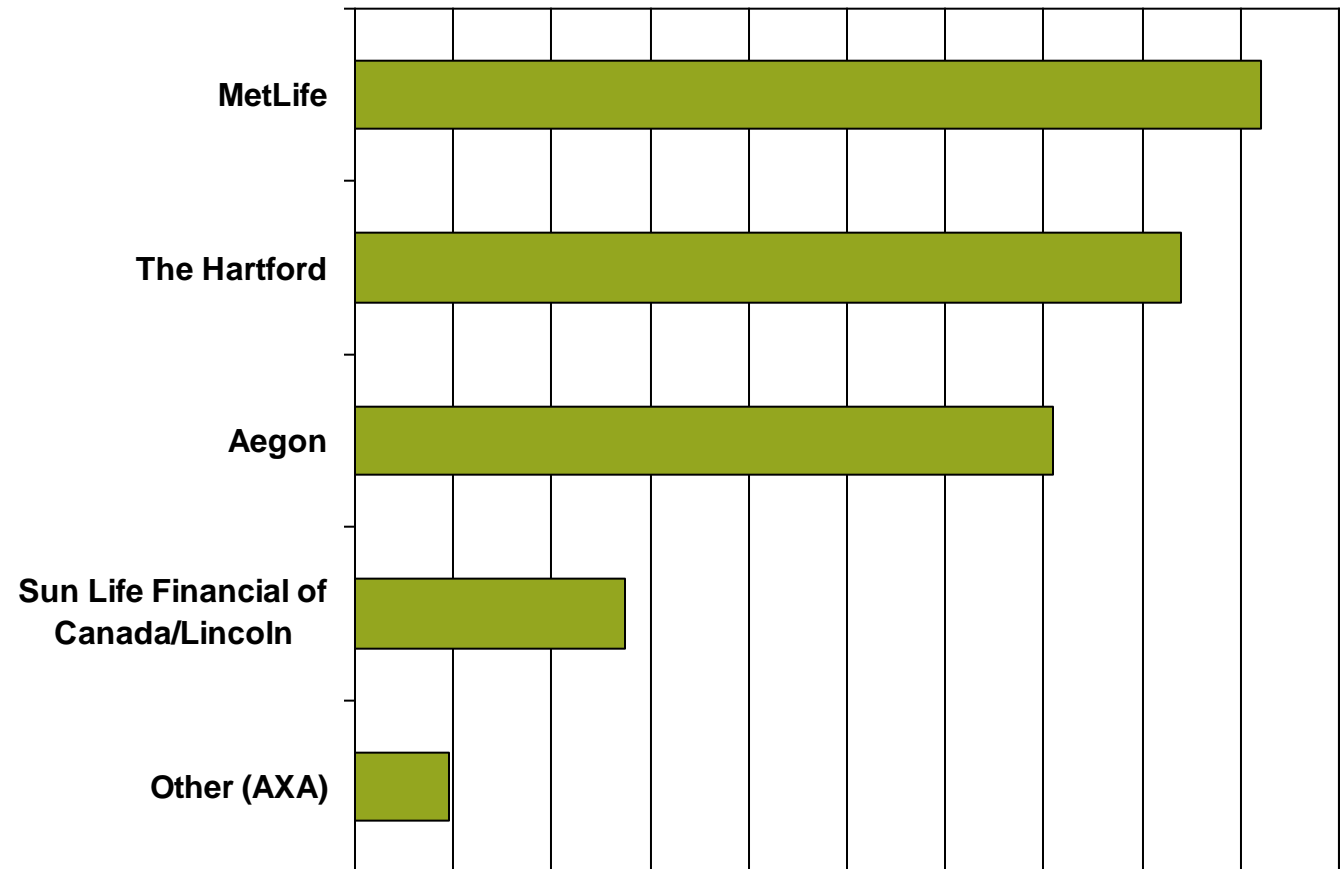
Product design and pricing

10. What would be your approach to the level of investment flexibility offered within the product?
Please tick one



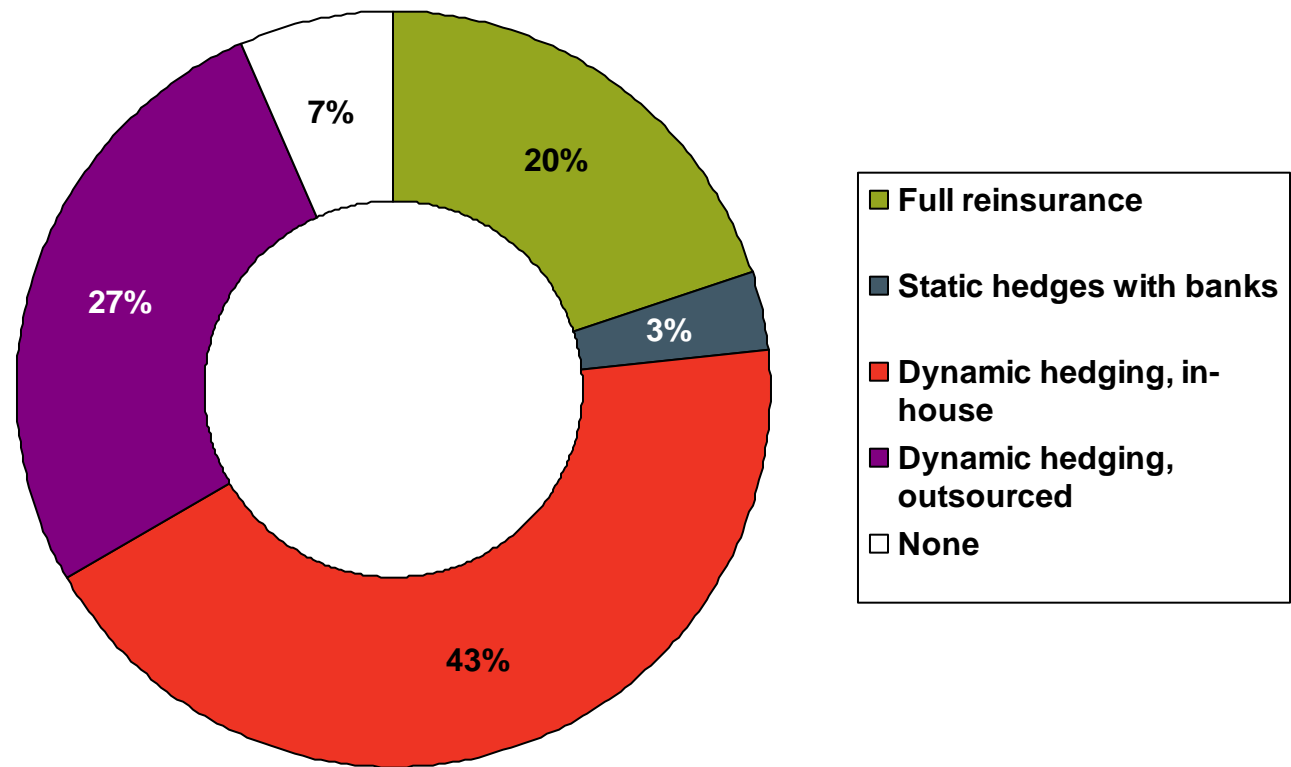
Product design and pricing

11. Which existing VA brands do you best associate with the VA market?
Please rank top 3 (rankings shown reflect combination of all responses)



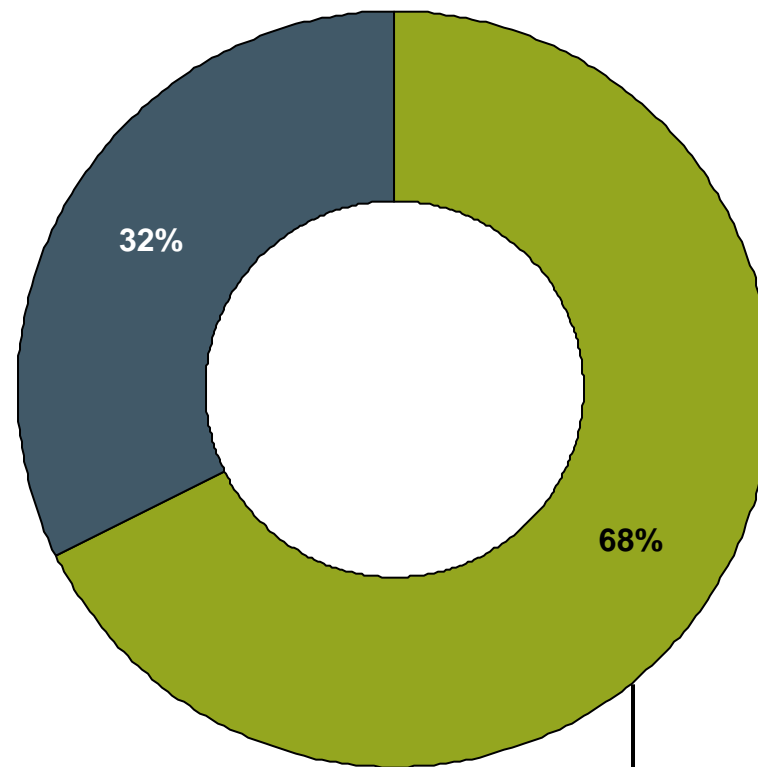
Risk management

12. If you are in or would consider entering the VA market, what is your preferred initial risk management strategy? Please tick one



Risk management

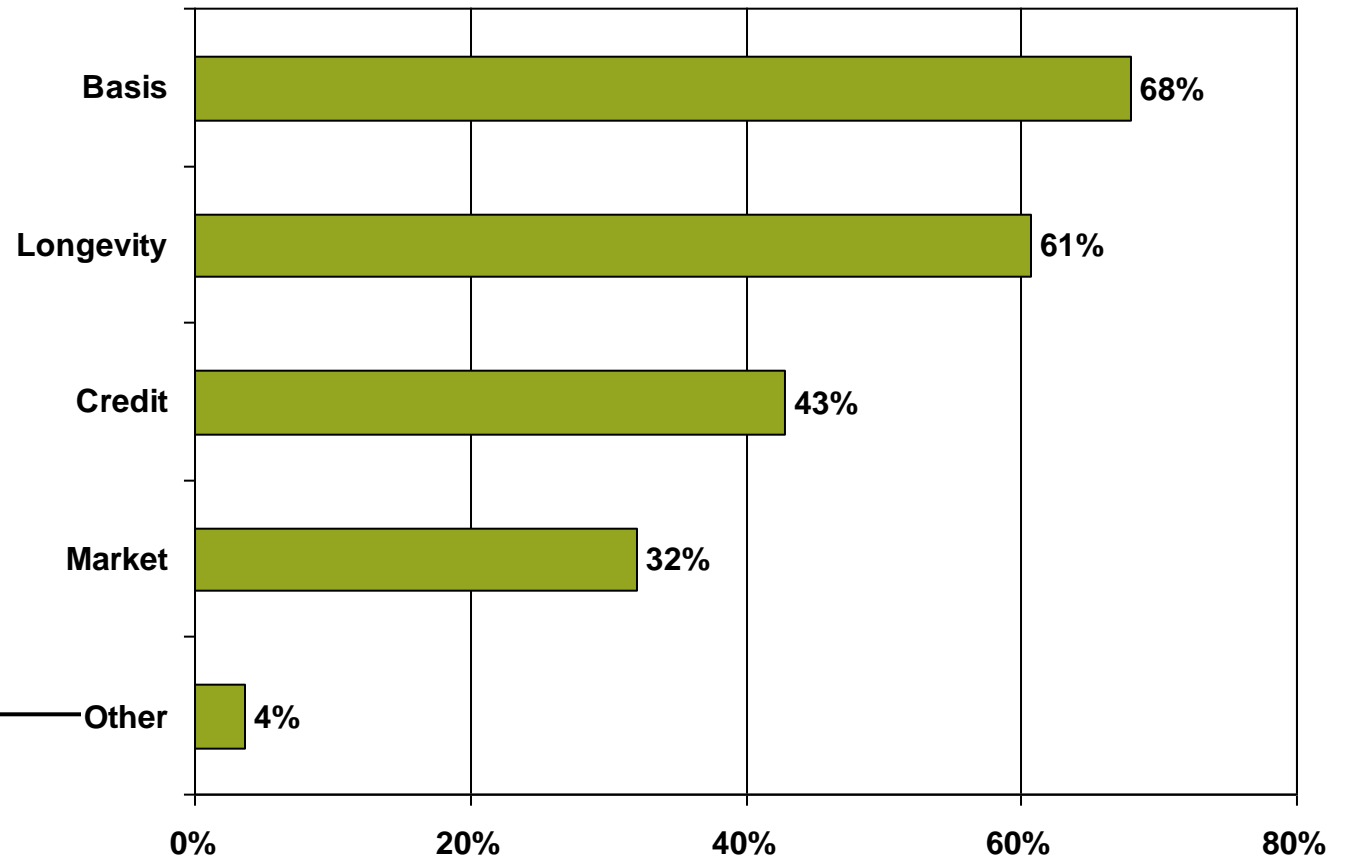
13. Would this preferred strategy vary over time or on the size of the book of business? If yes, please specify



Move to dynamic in-house as volume and experience increase
Reinsurance
Incorporate more than one primary means of risk mitigation

Risk management

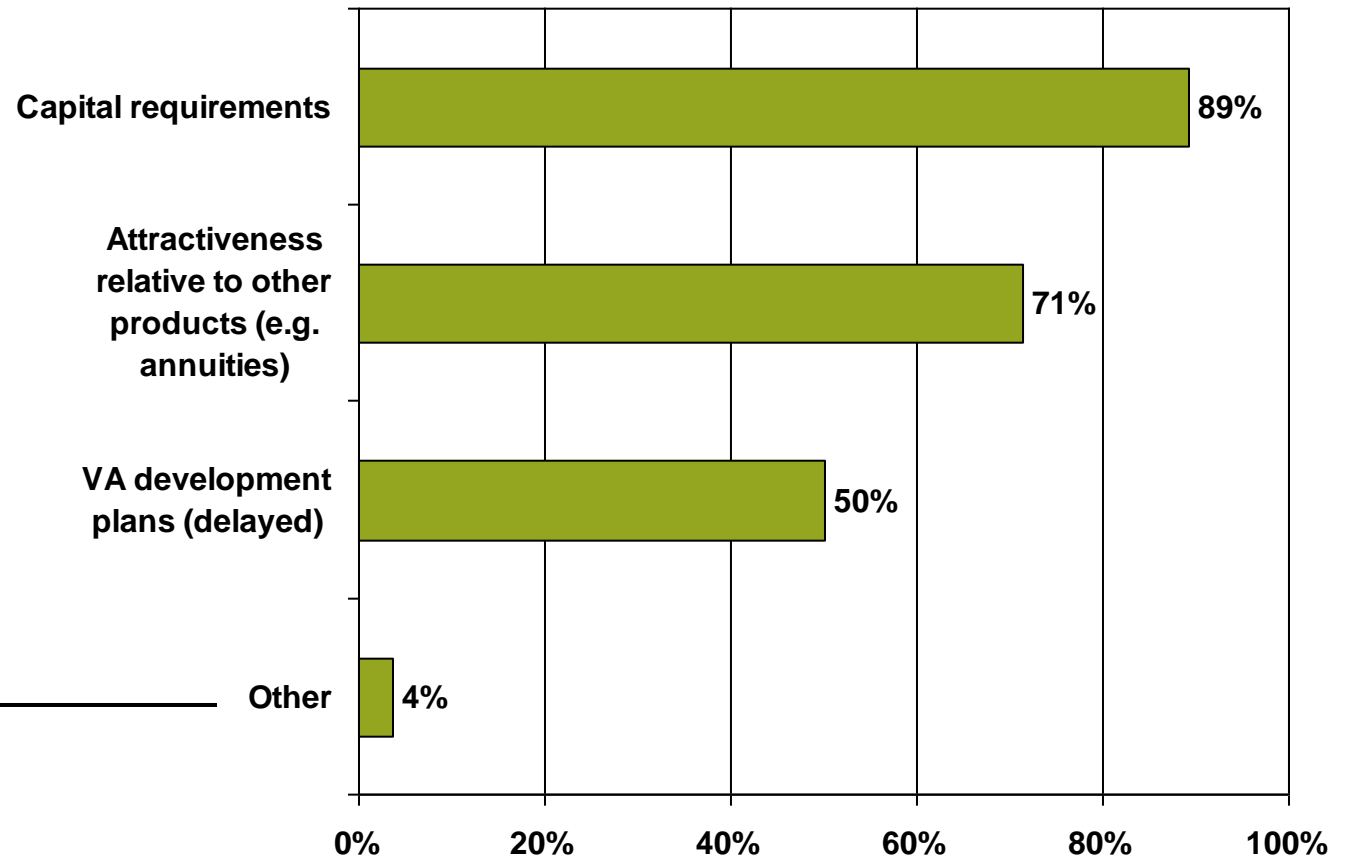
14. Which risks, if any, would you consider retaining and managing on your balance sheet? Please tick all that apply



Retain some of every risk category on balance sheet, but also mitigate each one with best available mitigation strategies

Risk management

15. Do you consider that Solvency II will have any of the following impacts on VAs? Please tick all that apply



Internal model – if the model is approved at an economically sensible calibration, it improves all the above

The future

16. What do you see as the critical success factors for variable annuity providers going forward? A selection of responses are shown

- A big name entering to give confidence
- Affordability of guarantees
- Attack the pensions market
- Capital requirements
- Client confidence in longevity expectations and investment management
- Establish product as market standard, not niche
- Has to be a reason for buying a VA – the industry rave, but no-one wants one
- How they are marketed
- Market awareness and education
- Managing and justifying the additional charge
- Products need to be simpler and cheaper
- Regulatory requirements
- See simple products to mass affluent – base on OEIC chassis
- Show how its better than conventional or normal unit-linked product
- Stop calling them “VAs”
- Top class risk management

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