



The Actuarial Profession

making financial sense of the future

VARIABLE ANNUITIES

Proposition Development, TCF and Regulation

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Proposition Development

Regulatory Environment

Variable annuities are unit linked products with guarantees

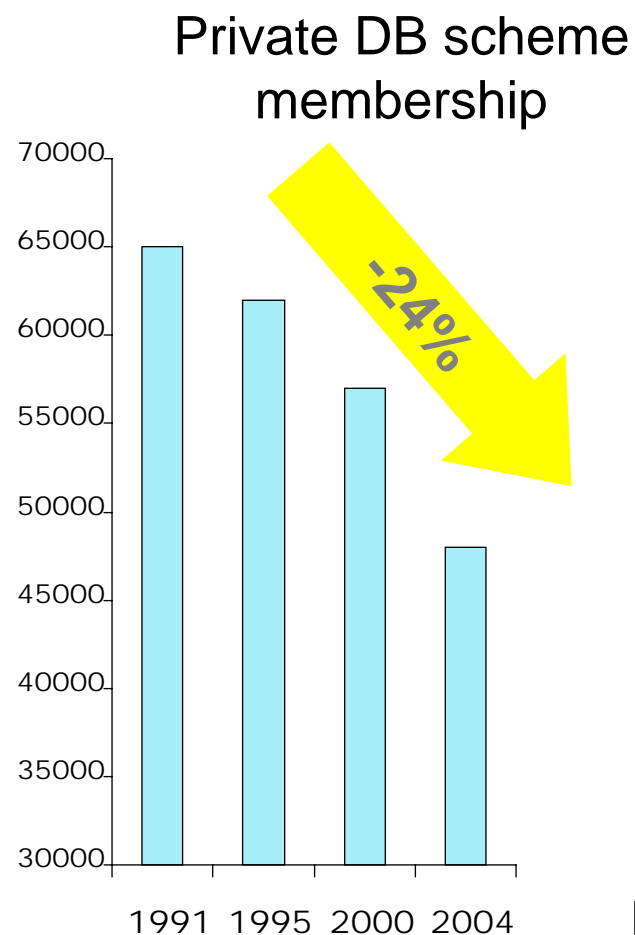
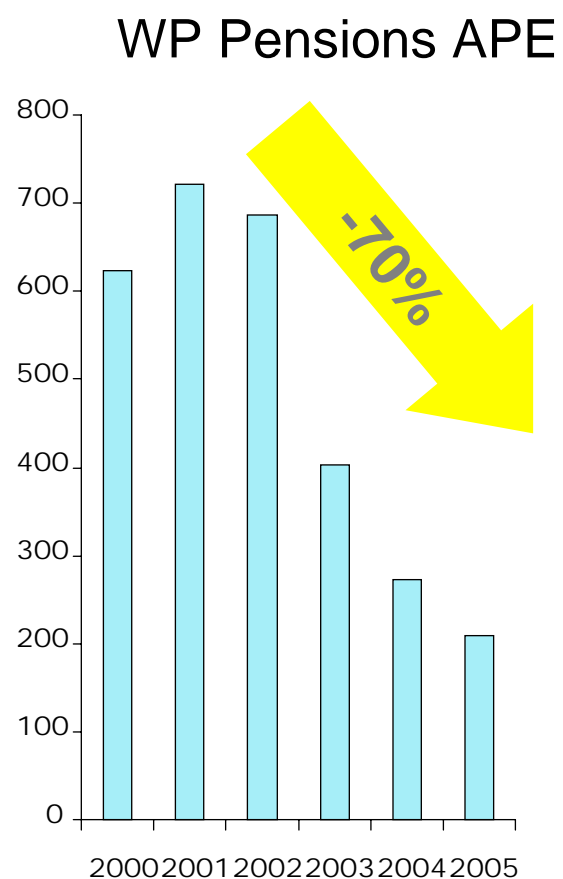
- NOT an annuity, but rather ...
- ... a basic unit linked chassis with a variety of “building block” guarantees:

Guaranteed Minimum Death Benefit (“GMDB”)	Guaranteed Minimum Income Benefit (“GMIB”)
Guaranteed Minimum Withdrawal Benefit (“GMWB”)	Guaranteed Minimum Accumulation Benefit (“GMAB”)

- Backed by a sophisticated risk management program
- The guarantees can be completely independent of the base product

The VA “menu” of guarantees opens up a new world of innovative possibility in product design

History shows a clear role for guarantees, particularly at/near retirement



What are the
21st century
replacements?

VA style guarantees provide a way to combine peace of mind underpin with upside potential

Big decisions as retirement approaches. Move from accumulation to decumulation and become more risk averse. What to do with the:

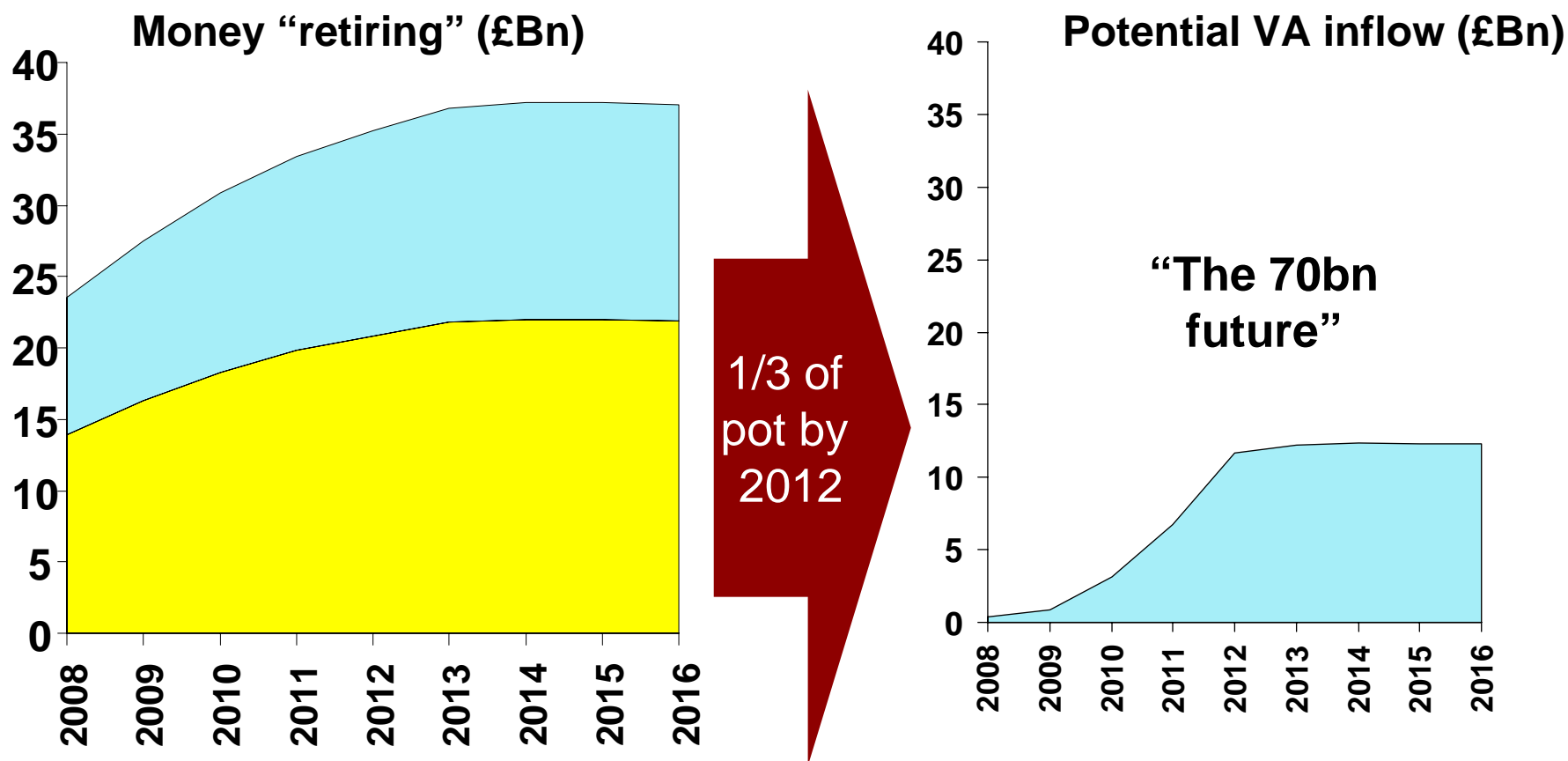
- PEP & ISA
- Personal pension
- Non-wrapped savings and investments
- Life bond

Options:

Cash, fixed annuity	Potential VA market	Asset allocation, drawdown
100% peace of mind, appropriate for some	The middle ground?	Sophisticated service, appropriate for some

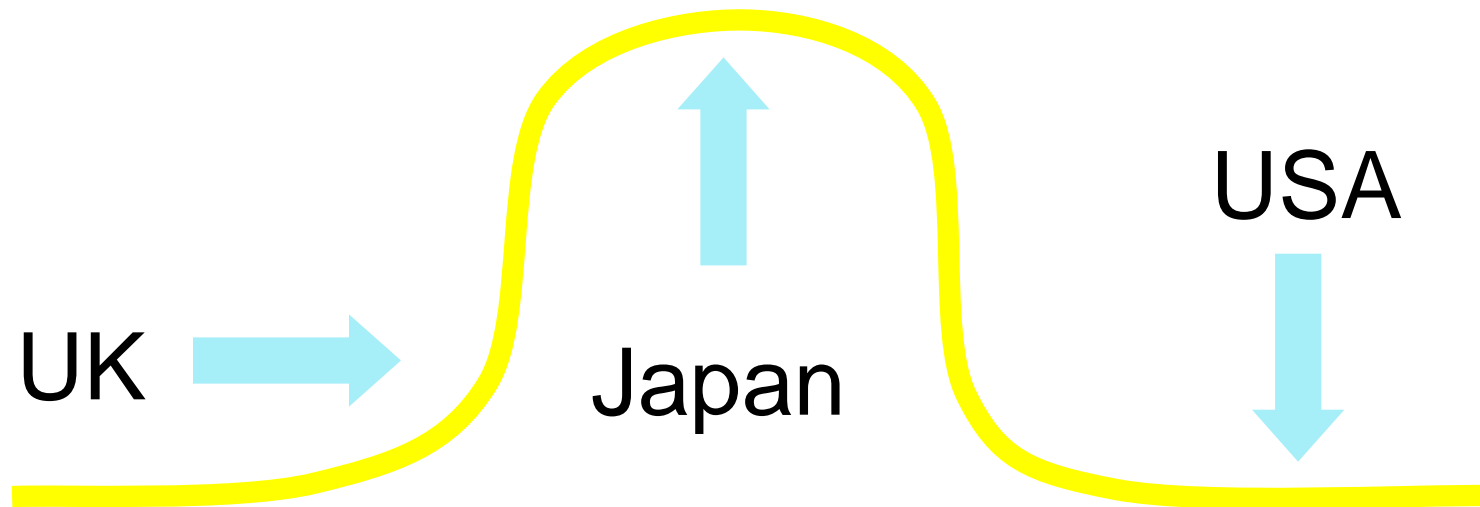
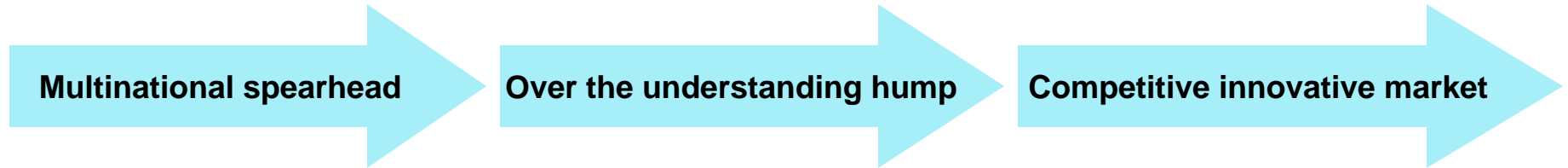
If the industry gets its act together, cross-wrap VA style guarantees could be used to cover 1/3 of the money “retiring”

Baby boomers are starting to retire with lots of money and no obvious place to put it

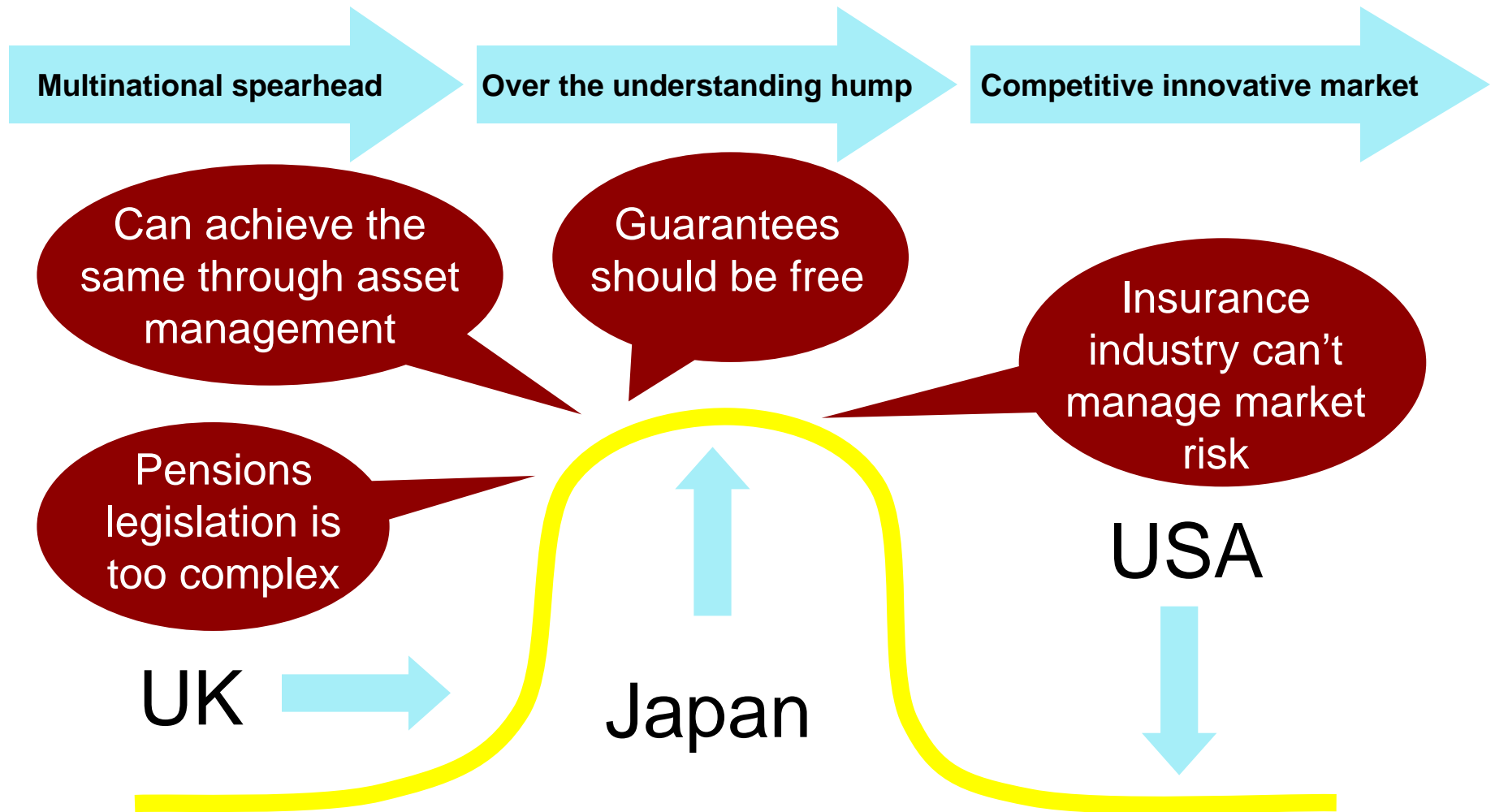


£70bn future? Need to believe insurance industry can position VA as core element of cross-wrap retirement planning over the next 5 years

Can the industry navigate the UK over the “understanding hump”?

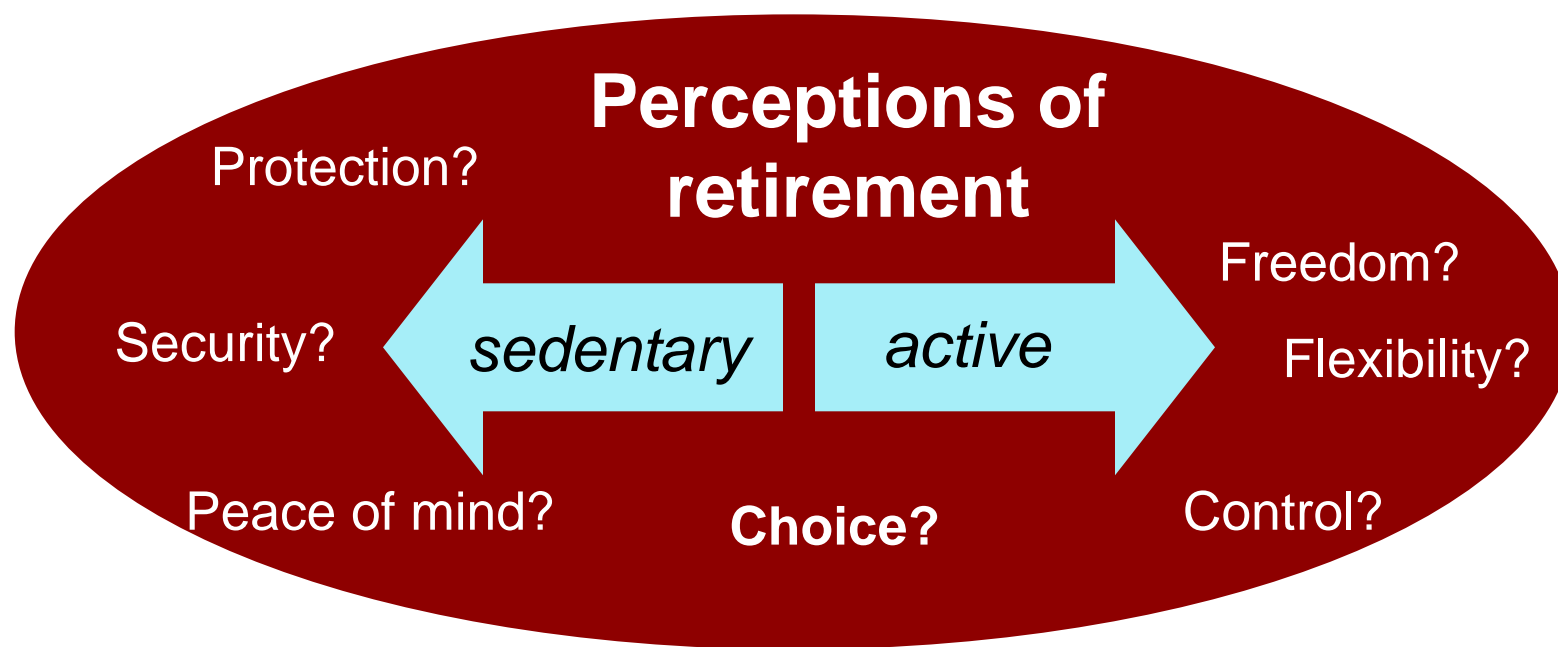


Can the industry navigate the UK over the “understanding hump”?



Understanding what customers value in retirement products will be key

Are customers unsophisticated and irrational...
...or have we misunderstood what they value?



There is an industry-wide need to learn how to best use the building blocks VA places at our disposal to support people's lifestyles

It will be critical to engage and support key distributor influencers to shape reactions

Money Management – April 2007

- “The Hartford's new offering to the UK pensions market initially looks attractive. It offers the security of an annuity, but with the benefits of a guaranteed lump sum on death below age 75 under drawdown rules and the potential for protected income growth
- The most obvious downside is having to pay an extra fee for any additional benefits, such as GRIP, or investment in a more actively managed fund
- Other pension products, which offer an alternative to standard annuities and drawdown contracts, are not easily compared with the Hartford plan”



I'm interested...



...but confused

- Is it good value for money?
- How can I compare it to alternatives on the market?
- When can I recommend it?

How much airtime do you think you'll get?

The challenges are complex and there is no “silver bullet” VA product or strategy

- Companies need to create the conditions for sustained success through *commercial* organisation around *what customers want...*

Commercial alignment around customers

- Investment in understanding attitudes and needs
 - Sophisticated segmentation
 - Positive messaging: Access, flexibility, choice, performance
 - Multi-wrapper solutions (outside life and pensions)
 - Packaged consolidation vehicle → open architecture retirement planning tools
 - Active monitoring of competition
- ...within a regulated environment

Proposition Development

Regulatory Environment

Setting the Scene...

- **Eleven Principles of Business (PRIN 2)**
- **High Level Principles**
- **Onus on the Industry to use Judgement to Interpret**
- **FSA Continues to Provide Further Guidance**

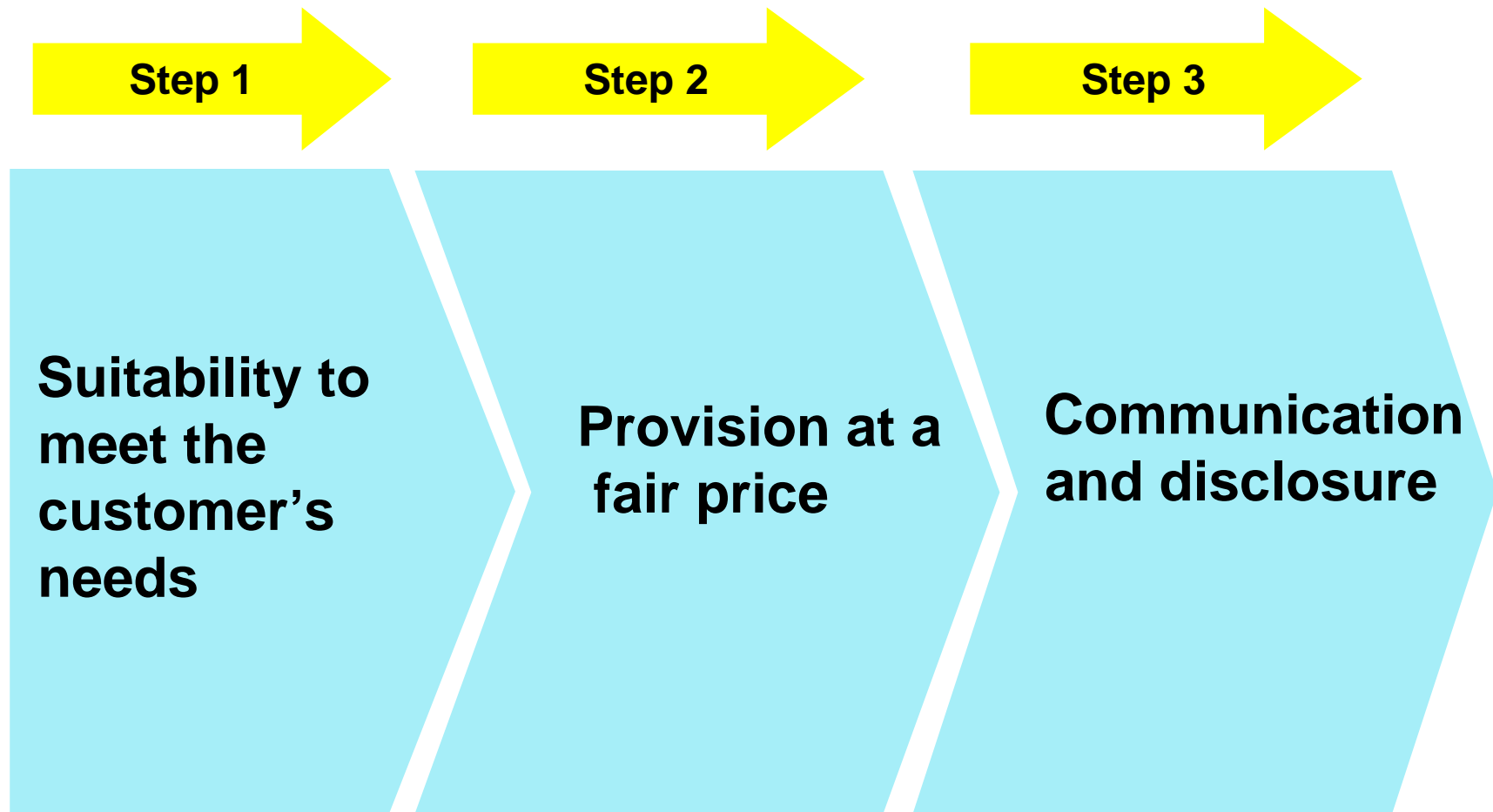
Customer Based Principles for Business

“Principle 6 - Customers’ interests - A firm must pay due regard to the interests of its customers and treat them fairly.”

“Principle 7 - Communications with clients - A firm must pay due regard to the information needs of its clients and communicate information to them in a way which is clear, fair and not misleading.”

“Principle 9 - Customers: relationships of trust - A firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgement.”

Challenges in Developing a VA Proposition

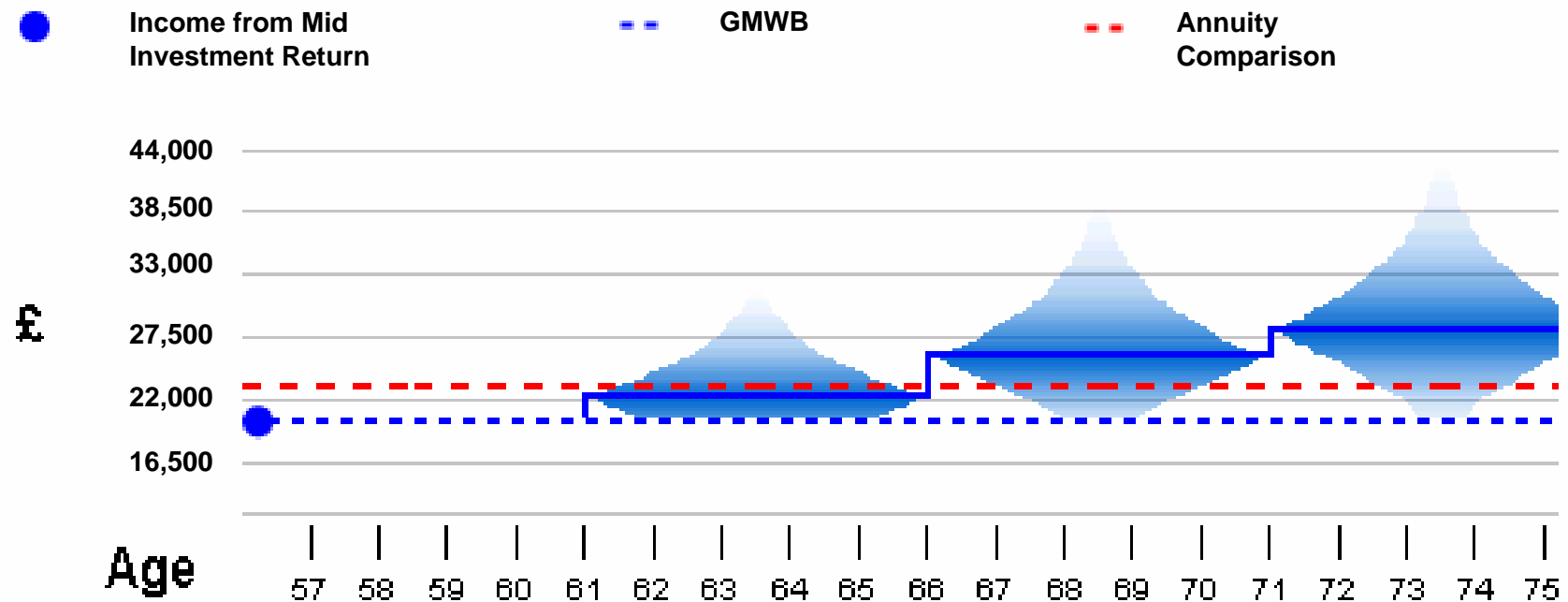


How do we Compare Apples and Pears.....

Product	Rising Market	Falling Market	Mortality Risk	Longevity Risk
Conventional Annuity	X	✓ ✓	X	✓
Variable Annuity (GMWB)	✓	✓	✓	✓
UL Drawdown (no guarantees)	✓ ✓	X	✓	X

How do we Compare Apples and Pears.....

VA GMWB with guarantee (5 yearly reviews) compared with conventional annuity

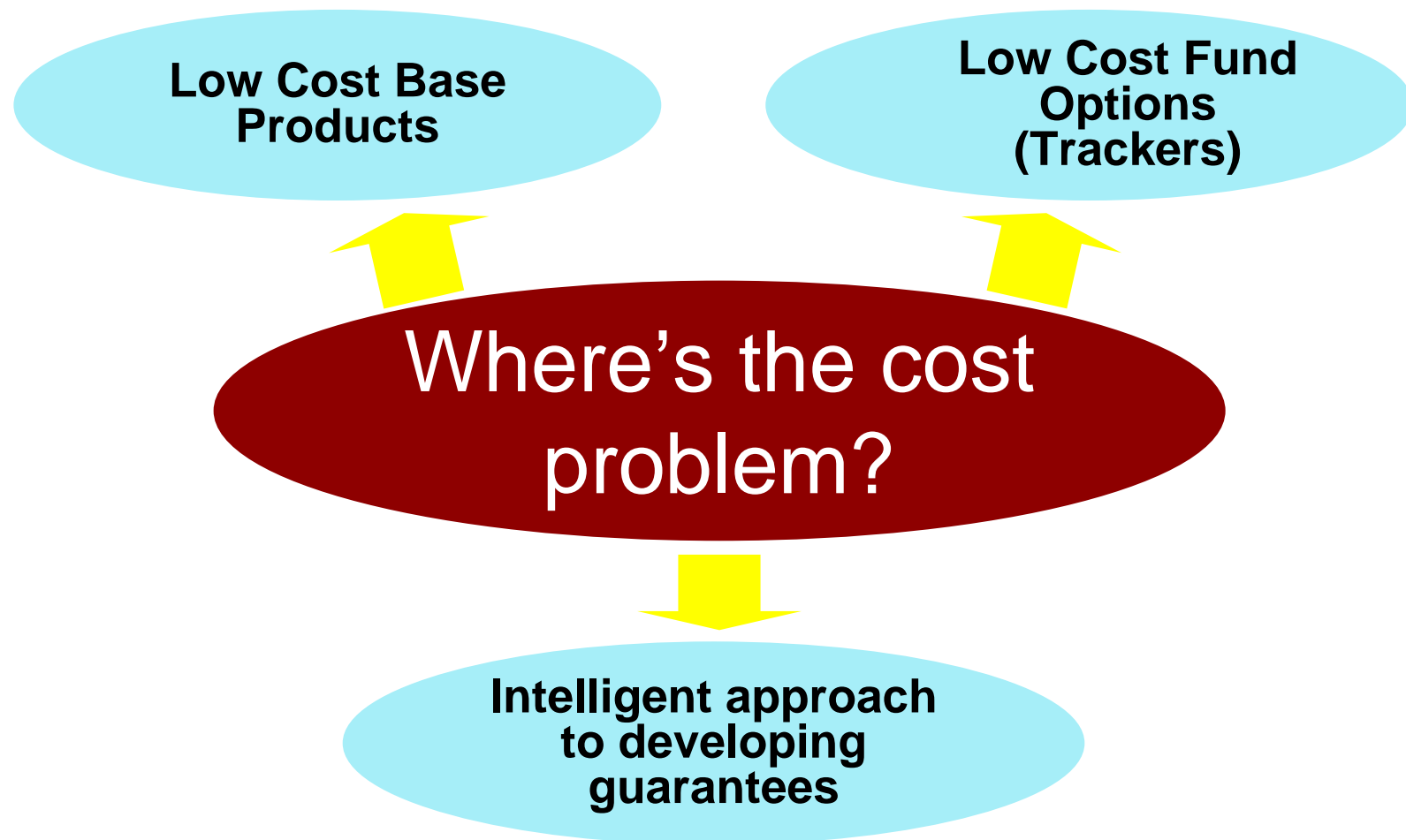


Source: Tillinghast eValue

Typical VA benefits and their cost in North America

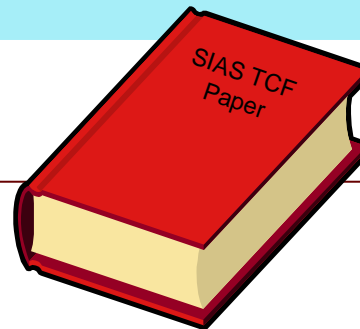
Type	Nature of Guarantee	Typical Waiting Period	Typical Guarantee	Typical Annual Charge
GMDB	Lump sum on death	None	Annual ratchet or 5% “roll-up” (annual accumulation rate), to age 80	15-35 bps
GMWB	Guaranteed withdrawals	None	Return of premium via 5-7% annual withdrawals — vanilla product provides over 14 years, new trend is lifetime for older ages	40-60 bp
GMIB	Guaranteed income at annuitization	10 years	5% roll-up. Income based on guaranteed purchase rate, not current	50-75 bp
GMAB	Guaranteed lump sum	10 years	Return of premium at year 10	25-75 bp

Market Reaction Suggest Costs too High...



The Communication Challenge

- SIAS Working paper on TCF suggests that to explain risks, some indication of:
 - The exact circumstance(s) under which risks to the customer may arise
 - The likelihood of the risks arising; and
 - The magnitude of impact
- required under all possible outcomes in a manner that can be understood by the laity.



Q & A