Dear Members

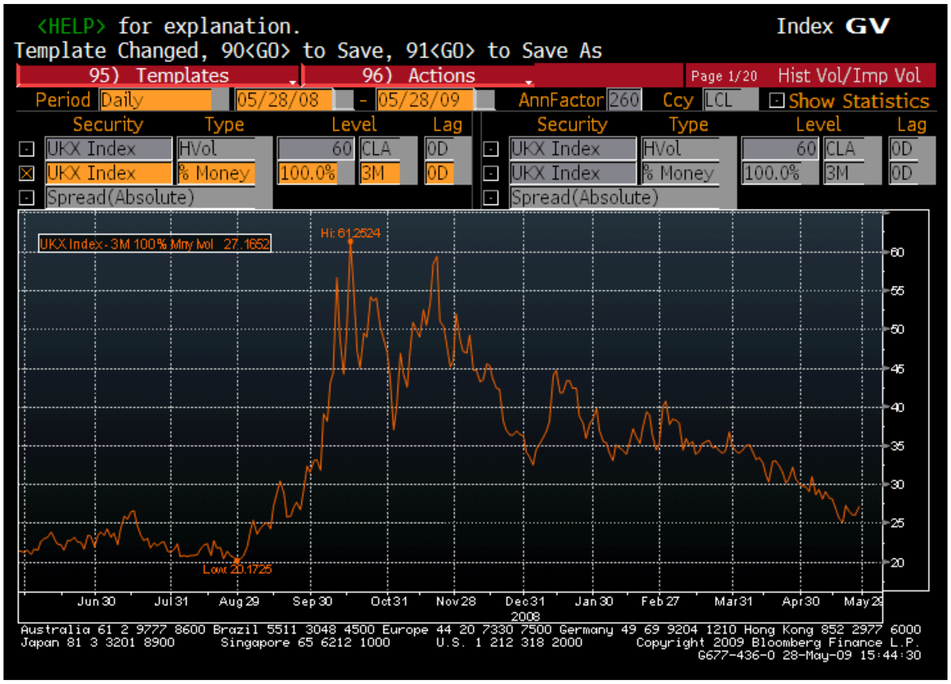
Welcome to the June newsletter for the VA MIG, content follows the usual format of :

- **Chairman's Comments,** *editorial freedom to the Chairman to provide commentary and views on the market and the MIG*
- **Recent Activity,** *an update on the activities undertaken within the MIG over the last month*
- **Recent Market Activity,** *an update on what has been making the news in the prior month*
- **Resource Centre,** *an update on website tools and content*
- **Vacancies,** *requests for assistance from the membership*
- **Upcoming Events,** *outline of relevant events*
- **Recent Publications**, *outline of recent publications not included in the Resource Centre*
- **Practice Area Bulletin - Report Back from Developments and Challenges in VA Seminar held in London on 15 May**

The sharp-eyed amongst you may notice that there has been no May newsletter for the VA MIG – fear not, you have not missed anything, we have merely moved the naming to reflect our outlook, that we are forward-looking!

Chairman's Comments

There appears to be a faint air of optimism in financial markets, if nowhere else. Market levels have returned to levels close to the start of the year and the "fear index" (as measured by short term implied volatility) has returned to a level reminiscent of those balmy days of late summer 2008 before the failure of Lehmans and the ensuing dislocations (see chart) and credit spreads have tightened up in similar fashion.



So have we seen the worst of it? Are we just experiencing a bear market rally, or might this be the beginnings of a sustained recovery? Who knows (and be wary of those who say they do!)? For my own perspective I would best view it as a typical British Summer - enjoy it when the sun shines, don't let the threat of rain dissuade you from venturing outside, and if you do venture out either don't venture too far from shelter or keep an umbrella (or other appropriate protection) close to hand.

Getting back to our favoured topic of Variable Annuities, I had the pleasure of attending the Life CPD conference "Developments and Challenges in the Variable Annuities Market" that was held at the Law Society in London on the 15th May. The event was well attended by many of the great and the good of the UK market, together with some interested visitors from overseas. The overall tone was one of constructive analysis and reflection, rather than either wild exuberance or deep despair, and was all the more valuable for it. A potential alternative title for the conference could have been "What doesn't kill you makes you stronger" with the unsaid epithet that you actually do need to survive! Josh Corrigan will go into more detail as to the findings presented at the conference, however I would like to note a couple of key contributions. In particular there were excellent presentations by Paul Brett of MetLife UK and Fabien Ruprecht of Axa Life Switzerland who were unambiguous and in some cases brutally honest as to the experiences of the recent past and the required adjustments that need to be incorporated into the business model going forward. Unsurprisingly these evolutions (revolution does not seem to be required) are both in product design/pricing as well as through hedging and risk management. Some challenges to the enduring ability of the industry to provide this were laid down, not least the possibility that appropriate capital market hedging solutions may not always be available (or, at least, not always at a reasonable price), although some participants remain positive about the outlook in this area.

The award for "champion of the people" must surely go to Dave Campbell of Standard Life who lifted our spirits with the reminder that what we are building, irrespective of the challenges, are propositions that customers say that they want and need. And in particular, to acknowledge that the purpose behind our endeavour is helping to ensure customer peace of mind in and at retirement - amen to that!

Finally, a personal hot topic and one that raised its head at the conference, is the perennial focus on the damage inflicted on companies due to the guarantees that accompany them. This has suppressed discussion on the more pervasive issue of DAC/EV impairment resulting from market falls on funds under management (and company charges/margins). I don't want to sound too much like a salesman, but is it not time for companies to start contemplating the need for at least basic hedging of commission streams? This can be achieved implicitly through the use of reinsurance financing arrangements, where there are funding benefits as well as risk management benefits, or through fairly simple delta hedging for market levels. This becomes all the more important where contracts have early termination features based on attaining target performance levels such as we have seen in Japan and have seen signs of here in Europe.

But the enduring message I, and many others, took away from the conference is that the summertime for Variable Annuity offerings in UK and Europe is now well underway – not everyone has yet turned up at the beach, while undoubtedly some will stay away with their raincoats and umbrellas at the ready (and, to be fair, there are likely to be many clouds, some rain and maybe even storms ahead), but there is much potential ahead of us!

Recent Activity

Paul Shallis and I had the pleasure of presenting at the Developments and Challenges in VA seminar referenced above on the topic of the VA MIG with a particular focus on the activity of the Product, Pricing and Opportunities practice area. An item worth reporting back is that there as yet seems to be a low level of awareness of the overall Members Interest Group program among the profession at large. This can be addressed to a certain extent via the profession distributing more emails however the real power lies in word of mouth so please feel free to share your comments and thoughts with your colleagues as to the wealth of available groups to associate with through the profession.

Current Market Activity

This month saw the formal suspension of acceptance of new business by Hartford Life, and it has recently been reported in some of the trade press that Aegon are to be changing their “Five for Life” product in due course – we will bring you more details when this is confirmed.

Resource Centre
The Discussion Board is now open for business and can be found at

http://kan.actuaries.org.uk/_layouts/login.aspx?ReturnUrl=%2fvariable%2fWiki+Pages%2fHome.aspx

Access to the site is protected so Users need to sign in using their standard ARN and password details to view the content and to participate in the discussions. (If you have recently joined the VA MIG or would like to sign up to become a member, please inform Rachel Smith who can grant you the permissions required to access the site. For your information we have circulated a Users Guide along with this month’s newsletter; this provides additional information including how to upload documents, check them out etc.

To start the ball rolling, our Wiki Discussion Team have proposed the following questions to the Forum and we welcome your engagement and response in addressing them:

- Is there a future for VA? The recent losses made by many VA providers and the current awareness of the heights volatility can reach and the extent of basis risk, all push providers away from providing these guarantees or at least encourage provision of simpler shorter-term guarantees. Is there a way in which providers can realistically provide very long-term guarantees, or would they be wiser not to attempt to do so?

- How large is the market in the UK/Europe currently? And what is the size of the market potential?

- From a regulatory point of view, Conditional Tail Expectation methodology seems to have been adopted by some companies when setting appropriate levels of capital to back VA guarantees.
  - what is the theory backing the appropriateness of say Max (CTE65+SM, CTE90)?
  - as S II approaches, does anyone have a feel for likely impact of move from CTE to mkt consistent RBC approach?

- Explain the 3 Greeks to me again.

As is apparent from above, the range and complexity of issues for potential is very broad and for the avoidance of doubt there is no such thing as a bad question; questions and answers can be anonymous, all we ask for is genuine participation. We hope to help out our wiki team in answering their questions and your own burning questions over the coming weeks and months.

Vacancies

Pedro Ortiz will join Jeremy on the Editorial team and will be helping to source market information for inclusion in the news letter going forward. Please contact either Jeremy (at jeremy.nurse@watsonwyatt.com) or Pedro (at pedro.ortiz@aig.com) if you have any newsworthy items to report.

We are always happy to hear from others who are willing to contribute towards our ongoing efforts, so please feel free to contact Rachel Smith at rachel.smith@actuaries.org.uk if you would like to get involved with the VA MIG in any way.**Recent Publications**

Nothing to add at this stage, but if you have read anything of interest recently that may be usefully disseminated to the rest of the MIG then please feel free to contact me with details at jmaher@nexgenfs.com.

Practice Area Bulletin

Review of the Actuarial Profession's "Developments and Challenges in the Variable Annuities Market" conference held on 15 May 2009 – by Josh Corrigan.

The seminar generated a lot of discussion during the day, centred on the themes of product development, the customer proposition, and risk management in the new financial environment.

On the product development and pricing front, we heard from a number of presenters who reiterated their belief in the value proposition of VA products. Indeed, given the market environment we have recently experienced, demand for guaranteed wealth and retirement income products is now stronger than ever. The gauntlet has been thrown down to the manufacturers to step up to the plate and seize the opportunity presented by the market.

Gary Finkelstein noted in his presentation that despite the challenging market conditions, product development is continuing apace. There have been half a dozen or so product launches since October 2008 throughout Europe, predominantly by existing players who are committed to the market. Dave Campbell from Standard Life provided a thorough overview of the customer value proposition and how it stacks up against the alternatives. Needless to say that his view, supported by research his firm has conducted, is that the customer proposition is very strong and he feels that the VA framework is well placed for providers to design products that meet the core needs of customers. However despite this, he feels that the industry still has some challenges in front of it in the communication of the proposition, and pointed to the need for stochastic illustrations to properly assess and compare alternative products. Paul Brett from MetLife outlined the different ways in which product features can be modified in order to reach an attractive and acceptable charge to the customer, even in these currently challenging times. Despite the recent increase in hedge costs, Paul outlined many of the product design levers that are available for manufacturers to use their creativity to meet customer needs with attractively designed and appropriately priced products.

Mark Hills gave an interesting and insightful presentation on the use of flexible annuities to provide post-retirement income needs in the UK pensions environment, upon which the Lincoln i2Live product is based. He outlined that as an alternative to an ASP, a flexible annuity has the advantage of being able to offer higher income, whilst at the same time policyholders benefit from the pooling of mortality risk through the application of mortality credits on the overall block of business. It will be interesting to see if other VA providers follow in Lincoln's footsteps in utilising this framework to provide guaranteed retirement income solutions to the market.

Fabian Rupprecht from AXA Winterthur gave us an overview of the use of VAs in the German and Swiss markets. His view was that the product is very well positioned to meet the post-retirement income needs in these markets, particularly compared to CPPI products which are currently quite popular.

There was also broad agreement by the current providers that in order for the VA proposition to gain further traction in the market, launches by one or more of the large domestic companies is ideally what is needed. Will we see these companies respond soon? … only time will tell.

Existing providers also noted that the market had been relatively slow to react to reprice their products when hedge costs increased in September/October last year. However they expect that in the future, risk management of the repricing cycle will be much tighter and that repricing will be much more responsive to changes in market conditions.

Billy Burrows gave us a unique insight into the distributors' perspective on the market. Having closely followed the market for a number of years now, Billy's view is that he believes that the market is also well positioned to meet the needs of the "middle Britain" market segment. VA's have an important role to play in a retirement plan in conjunction with both income drawdown and fixed with-profit and non-profit annuities.

Yours truly and Sam Nandi from Milliman kicked off the more technical risk management discussion for the day. One of the key take-away points is that the hedging of VA guarantees has successfully withstood perhaps the most severe stress test that anyone could have even thought of a few years ago. Where losses have occurred, these have been driven not by hedge breakage, but by companies choosing to not hedge an economic exposure due to accounting or strategic reasons, or via DAC write-offs. Basis risk and credit risk have been the two risk factors that have gained the most attention and are consequently coming under increased scrutiny in the near future. As a consequence of this, the use of hedging can be expected to increase in the future, particularly in light of the increased market scrutiny due to the failures of risk management in the banking industry.

Paul Brett outlined that MetLife's hedge program has performed well over the course of 2008, having sufficiently met the increase in liabilities. He saw the remaining risk management challenges for VA writers as being the need to generate sufficiently detailed and meaningful MI to help non-experts understand the risk management of the business, to put further controls in (for instance, through product design) to mitigate the impact of basis risk, and the possible application of hedging to earning streams in addition to the usual guarantee liabilities.

Fabian Rupprect from AXA noted that their new business margins were relatively protected from the increase in hedge costs in the short term, as they had benefited from the forward hedging of these margins for new business. This experience may prompt more players in the market to undertake this form of risk management to help them manage repricing risk.

Stefan Jaschke and Michael Winkler from New Re / Munich Re gave a technically detailed and comprehensive presentation into their experiences in reinsuring and hedging VA business. They outlined that there are a number of advantages to using generalized additive models to construct a robust core hedge involving options, with residual dynamic hedging.

David King from E&Y provided a discussion on the operational challenges involved in manufacturing VA business. Dermot Corry from Life Strategies gave us a very thorough walk through the issues involved in setting up cross border business models, for which all the existing VA writers have had to work through. He also discussed the differences in reserving and capital requirements for VA business between Solvency I, the current Irish approach, and how these are likely to change under Solvency II.

There was a broad consensus from the delegates that the conference was a very timely and informative one. I personally would like to thank all the speakers who contributed to making the day such a success, and I look forward to seeing you all and hopefully many more at next year's conference.

Josh Corrigan
joshua.corrigan@milliman.com