BACK TO THE FUTURE:

Opportunities for life offices in unit-linked business

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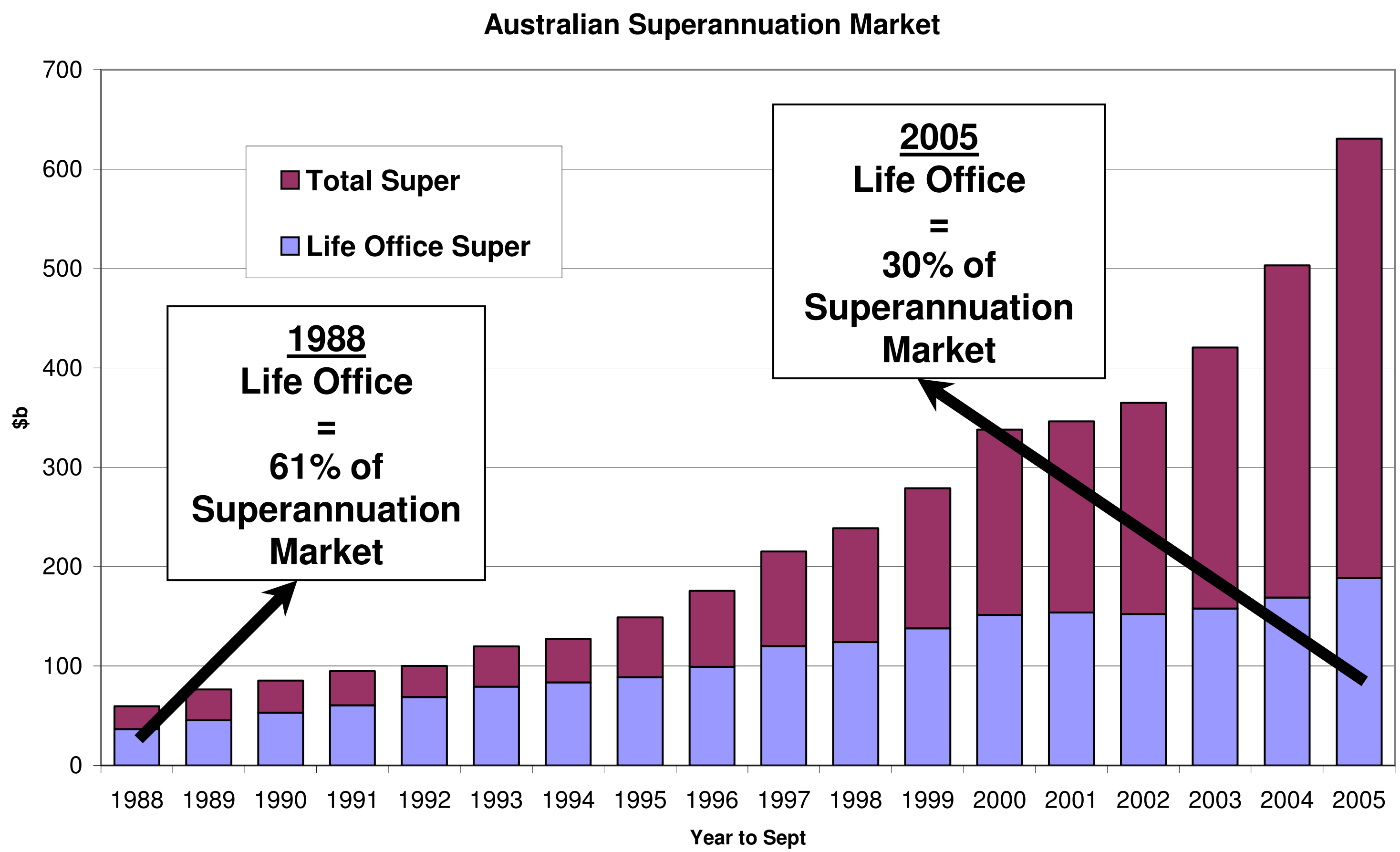
Outline and points for discussion

- Growth of unit-linked products and their importance to life office profitability
- Challenges and competition for unit-linked products
- Examples of unit-linked benefit guarantees
- Overseas experience
- Relevance to Australian life insurers
- Discussion

Life offices are losing market share in superannuation



Life offices are losing market share in superannuation

Life Office unit-linked products are <u>NOT</u> competing effectively in Australia's booming superannuation market

Why does this matter?

- If you can’t beat them, JOIN THEM!
  – e.g. channel business through a captive/conglomerate fund manager

BUT……….

- All risk is borne by the investors
- Life offices’ function as a risk transfer mechanism is being under-utilised
- Diminishing role of actuaries as risk managers

How can this be addressed?

Offer appropriate, affordable and marketable guarantees!

Why have guaranteed products not been so successful in the recent past?

- Rise in investor consumerism/sophistication meant demand for product flexibility and transparency of returns
- Good returns during the past decade have reduced the perceived value of guarantees (except those retiring after tech crash)
- Rational capital management requires charges that were not seen as good value for money

Who else is offering market returns with guarantees?

- Fund manager offerings
  - e.g. AMP China Fund, Macquarie ALPS/Atlas Series, Citigroup ORB Series
  - Guarantees backed by big name banks
- Restrictive Features
  - Limited **tranche-only** offerings (then closed)
  - **Single fixed maturity** date for guarantee (with early exit penalty)
  - **Locked-in** investment options and style

These products are completely restrictive for the consumer

Life offices can offer a flexible menu of market returns with a range of benefit guarantees

Feature	Guarantee example	Typical* charge (bps)
On death	•Capital guarantee •Capital plus 5% p.a. •Highest ever attained value	0-10 15-35 15-35
On maturity	•Capital guarantee (plus interest) on retirement •Capital guarantee (plus interest) at multiple dates	25-75

** See references*

Life offices can offer a flexible menu of market returns with a range of benefit guarantees

Feature	Guarantee example	Typical* Charge (bps)
On annuitisation	•Capital guarantee (plus interest) on retirement PLUS guaranteed annuity rates	50-75
On drawdown	•Guaranteed payout of 7% p.a. of retirement capital for 15 years •Guaranteed payout of 5% p.a. of highest ever capital value for life	40-65

** See references*

These guarantees are booming in the US

- The US Life industry developed these products to counter growth in mutual funds
- The US FUM for unit-linked products with guarantees is now **US$900billion**
- 75% of US Life Insurance CFO’s say investment guarantees are **critical** to sales
- Drawdown guarantees were included in **75%** of 2005 sales (only developed 5 years ago)

How do they do it?

Charges are used to:

1. Fund risk capital	Traditional approach
2. Transfer of risk to third party	•e.g. purchase a bank-backed hedge •Potentially expensive •Inflexible
3. Finance internal hedging program	•Over 50% of top US writers hedge these guarantees with an internal program •Dynamically rebalanced hedge portfolios of market traded derivatives - not a “set and forget” strategy •Actuarial assumptions (e.g. lapses) are as important as financial assumptions •Daily hedge portfolio calculations can be outsourced

So, what are the limitations?

- Guarantees become particularly popular when times are bad
- May not appeal to all demographics
- Need for rigorous pricing and reserving to guard against underestimation of risk
- The US regulator’s move from scenario based to heavier stochastic capital requirements is leading to product feature refinement

Would these work in Australia?

- Value of guarantee included in policy liabilities
- Apply resilience shock with guarantees
- Resilience Reserve recognises netting of derivative positions when determining the asset value post shock
- Daily responsibility would rest with the actuary to ensure the oversight of the hedging processes and regard for major changes in exposure positions

Discussion - Is this relevant for Australia?

- Would the market be interested?
- Could life companies administer them?
- Could life companies handle the accounting/capital issues?
- What is the role of actuaries in implementing/monitoring these guarantees?
- Would this help life companies re-gain lost ground in the long term savings industry?
- Would this lead to a more appropriate bearing of risk between investors and institutions?

Bibliography

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