

# Japan Variable Annuity Market

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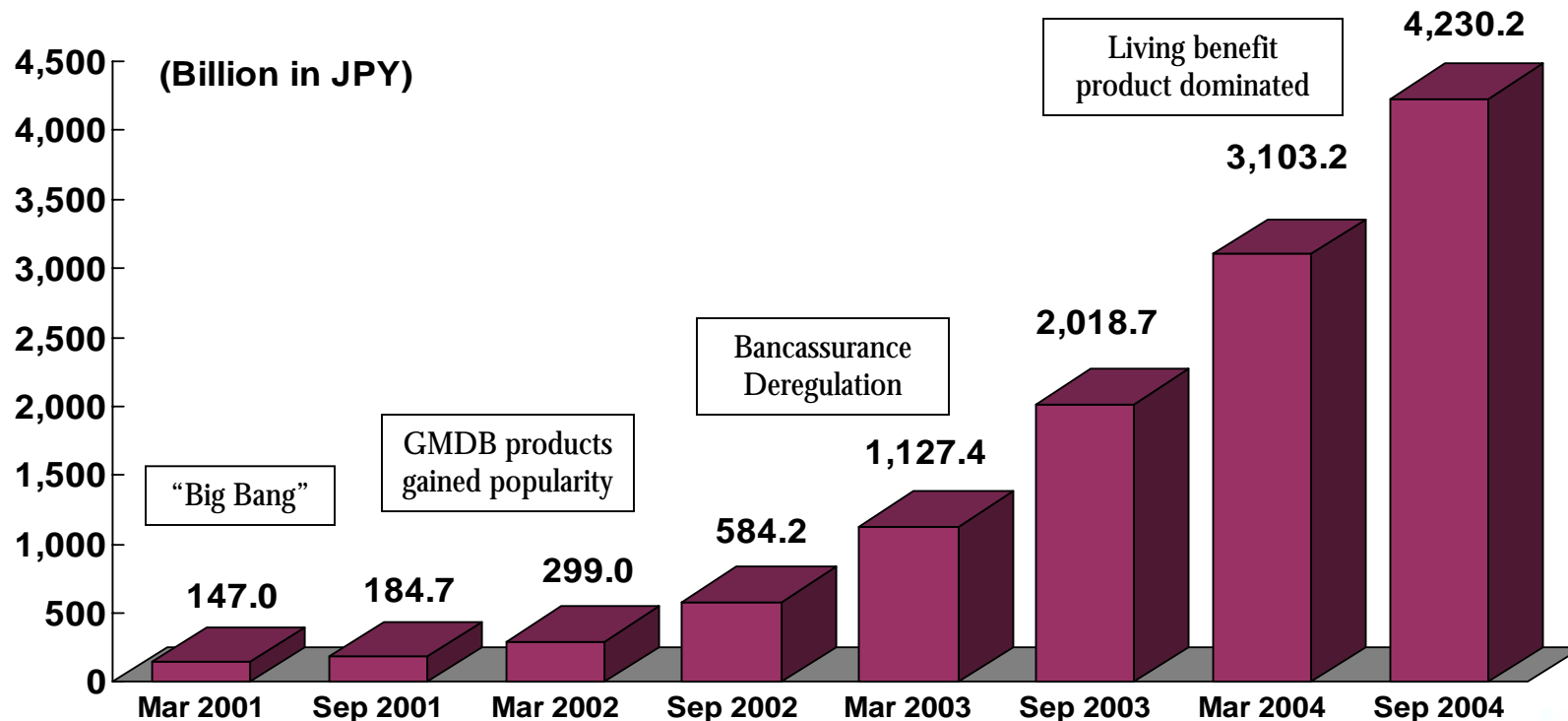


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- **Japan VA Market Background**
- **Japan VA Product and Risk Management Challenges**
- **Current Japan VA Market & Product Trends**

# Japan Variable Annuity Market

- Industry-wide variable annuity assets reached 4.2 trillion yen as of Sept. 30, 2004
- Japan's variable annuity market has the potential to reach 30-50 trillion yen by 2010



## ■ Product Development Challenges

- Regulatory challenges: product limitations and changing regulatory environment without transparency
- Lack of experience data especially policyholder behavior
- Limited investment options: low interest rates and volatile equity markets result in mostly balance funds

## ■ Hedging

- Low interest rate and high equity volatilities
- Most products have fixed balance funds for correlation benefits, but almost impossible to hedge
- Additional challenge to manage financials with hedge accounting not fully developed in Japan

## ■ Reinsurance

- Very limited capacity with a range of mixed risks
- Lack of track records and risk-neutral pricing methodology result in high reinsurance premium

## ■ **Japan Statutory Reserve & Capital Requirement**

- Statutory reserving for VA guarantees: risk neutral valuation, no (minimum) lapse
- Capital requirement: factor approach – minimum risk capital is 2% of guaranteed amount per guarantee
- Alternative method for capital: floored at 90% of the factor standard
- Need reinsurance to transfer risk outside of Japan to avoid unreasonably high capital requirement

## ■ **U.S. Principle-Based Statutory Valuation**

- Stochastic RBC (C3P2)
- New VA reserving methodology

## ■ **U.S. FAS 133 & Fair-Value Accounting**

- FAS 133 introduces volatility into GAAP earnings for GMAB and GMWB products
- SOP 03-1 allows stable GAAP accounting for GMIB and GMDB products
- Reinsurance creates further complications including tax accounting issues
- GAAP accounting is moving towards fair-value accounting

## ▪ **Outlook on Japan VA market very positive**

- Baby boomers at or approaching retirement age with vast amount of assets
- Further deregulation in the financial industry
- VA gains popularity as an investment and retirement vehicle
- VA market is expected to keep the current double-digit growth

## ▪ **VA product competition heats up**

- Mainly competing on product features: guarantees, income features and performance illustration
- Pricing remains stable with customers insensitive to fee level
- Investment options are not the driving force as fixed balance funds are still majority of the VA sales
- Significant increase in competition from local insurers

## ▪ **Issues and concerns with Japan VA market**

- Irrational competition could lead to price war and riskier guarantees
- Increasing complexity of products with not highly regulated sales practice will cause suitability issues
- Regulators start to scrutinize the VA industry especially sales practice

- **Maturing of Sales Tactics and Need for Market Segmentation**
- **Products to combat longevity & inflation risk**
- **Innovations to illustrate complex product in simple & effective sales stories**
- **Promotion of simplified annuities with lower fees**
- **Programs to strengthen compliance and retain assets**