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## Milliman Principal: 'Sustainable Manufacturing Model' Winning Over Variable Annuity Writers

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Source: A.M. Best Company, Inc.

Wordcount: 625

About half of all variable annuities sold today use a new concept that embeds risk management into the investment options, according to Ken Mungan, principal at the Milliman consulting firm in Chicago. "And it's growing at such a rapid rate, I believe it will become the primary manufacturing process in the VA industry in the relatively near term," he said.

"The financial crisis was a horrible experience for people as they saw declines in the asset values, but it was also an amazing laboratory for risk management," Mungan told Best's Insurance News at the American Council of Life Insurers' annual conference. He said it was exciting for him to see the industry proactively design new products and new manufacturing processes for those products to provide a more sustainable offering to the market.

Mungan calls the new approach the sustainable manufacturing model. That's because under products introduced before the crisis, insurers would have a liability on their balance sheets for the guarantees they provided, and they would also have to manage a portfolio of hedge assets on their balance sheets. During times of financial turbulence, that led to significant volatility in insurers' quarterly earnings and significant stress on their reserves and capital.

Under the new approach, insurers put risk management directly into the customer's portfolio, Mungan said. One way is to have the hedge assets placed inside the funds, with the result that the company has more stable quarterly earnings and less-stressed customers.

The trend is resonating with consumers and financial advisers, said Mungan. "When this effort began, there was concern that companies would simply take things away from consumers, but they found that consumers today very highly value risk management, that they want retirement savings products that include a risk-management process directly in the product," he said. Particularly gratifying has been the response from advisers, who Mungan said "are really the folks leading the charge in helping clients prepare for retirement."

As the financial crisis played out, Milliman's role was to work with companies to process all information being gathered and to search for "how the VA industry could operate at a better level in a fundamentally more sustainable way," Mungan said. Milliman collaborated with other companies to design funds that could be used to implement the sustainability model. One example was creation of the TOPS (The Optimized Portfolio System) Protected Portfolio in which ValMark, a securities firm, manages a basket of exchange-traded funds in three protected portfolios -- balanced, moderate growth and growth. Each portfolio includes hedge assets, and Milliman serves as a subadviser, Mungan said.

Traditional mutual fund providers are also creating funds with protection strategies. "So that development of a whole range of new funds means that VA writers can develop an attractive menu of funds and design exciting new products around the sustainable manufacturing model," said Mungan.

The model can be particularly important to policyholders in or near retirement that need to take systematic withdrawals during a bear market or after account values have hit bottom. "Having a protection strategy within a customer's portfolio means that the sequence-of-returns problem is largely solved," Mungan said. "The protection strategy is there to attempt to reduce declines in account value and give policyholders the ability to systematically fund withdrawals from the account and also benefit reasonably from a recovery in the market."

Ohio National was the first to adopt the model in an extensive way for its VA business, said Mungan.

Prudential Financial has adopted it for its variable universal life insurance business, and Jefferson National has included protected funds on its flat-fee VA platform. Another four or five companies have products in the pipeline, he said.

Listen to an interview with Mungan at: <http://www.ambest.com/media/media.asp?RC=193048>.

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