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Enhancing investment strategy; issues and opportunities in the current investment climate

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Backdrop to the macroeconomic environment

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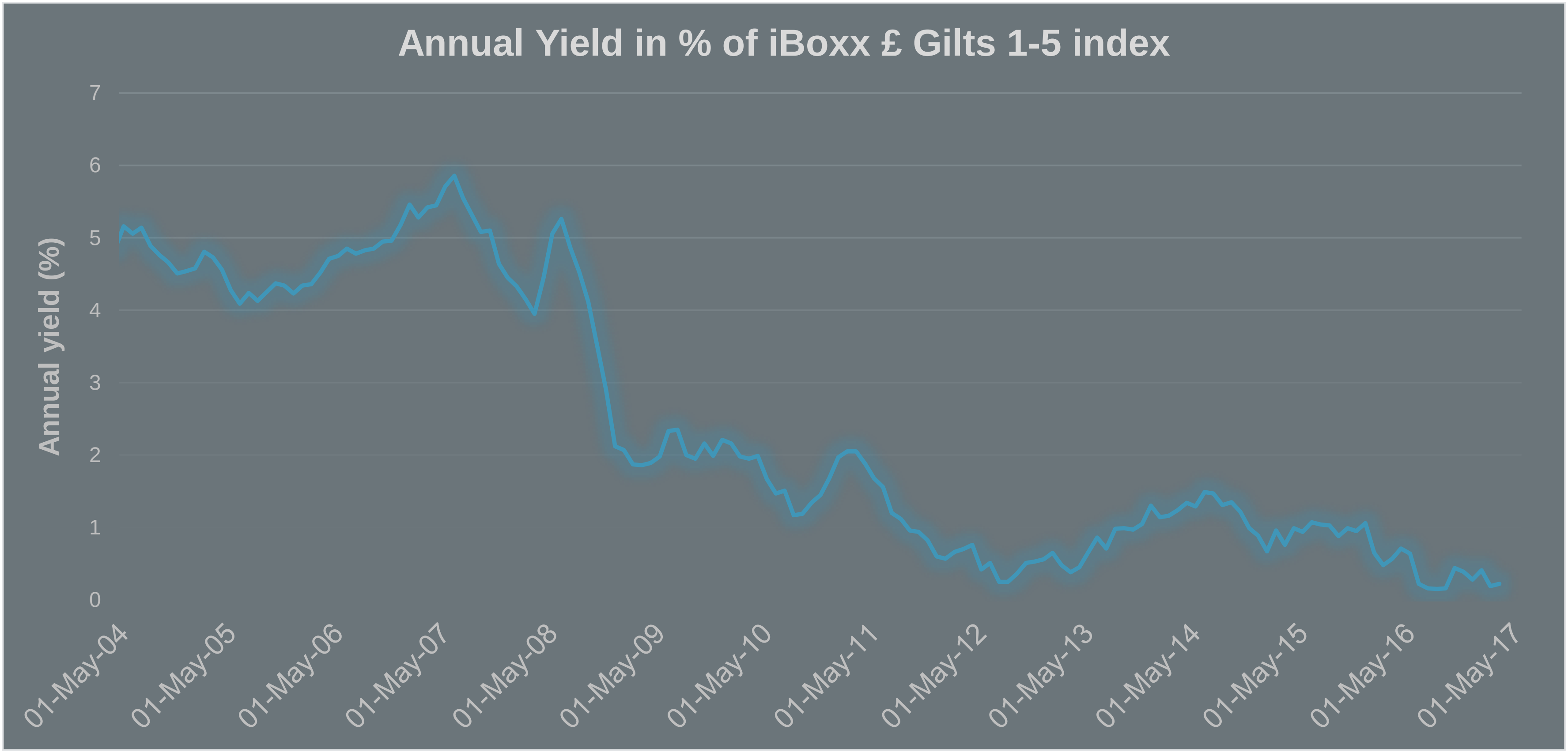
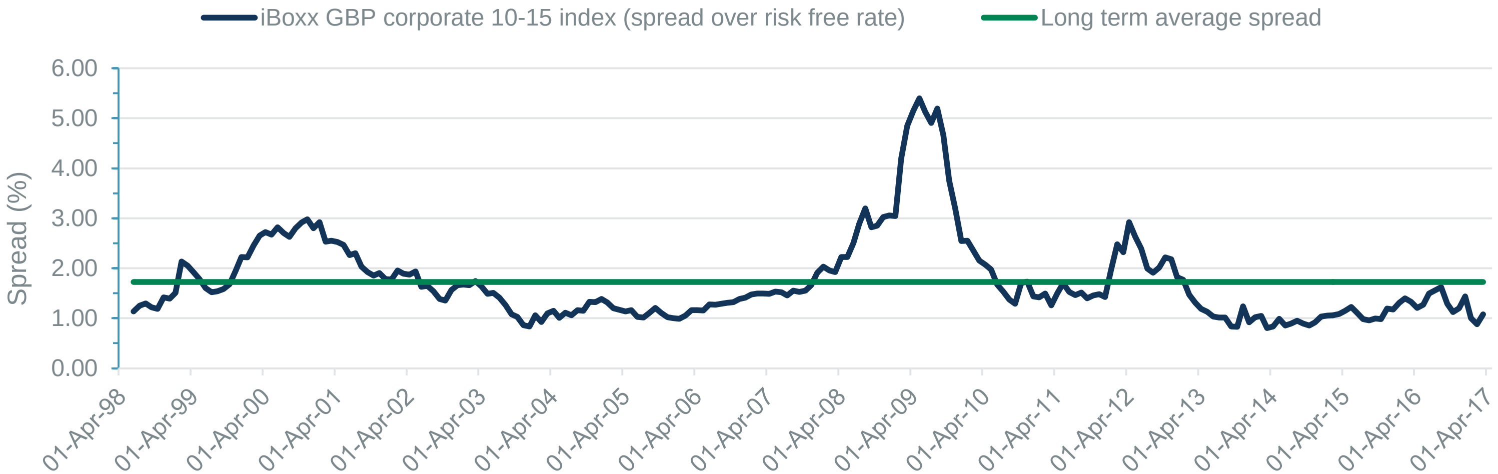
The search for yield continues amidst a challenging economic backdrop



The fall in the annual gilt yield emphasises the need for firms to search for yield

Source: Markit, iBoxx £ Gilts 1-5 index

The search for yield continues amidst a challenging economic backdrop



Spreads are below long term averages

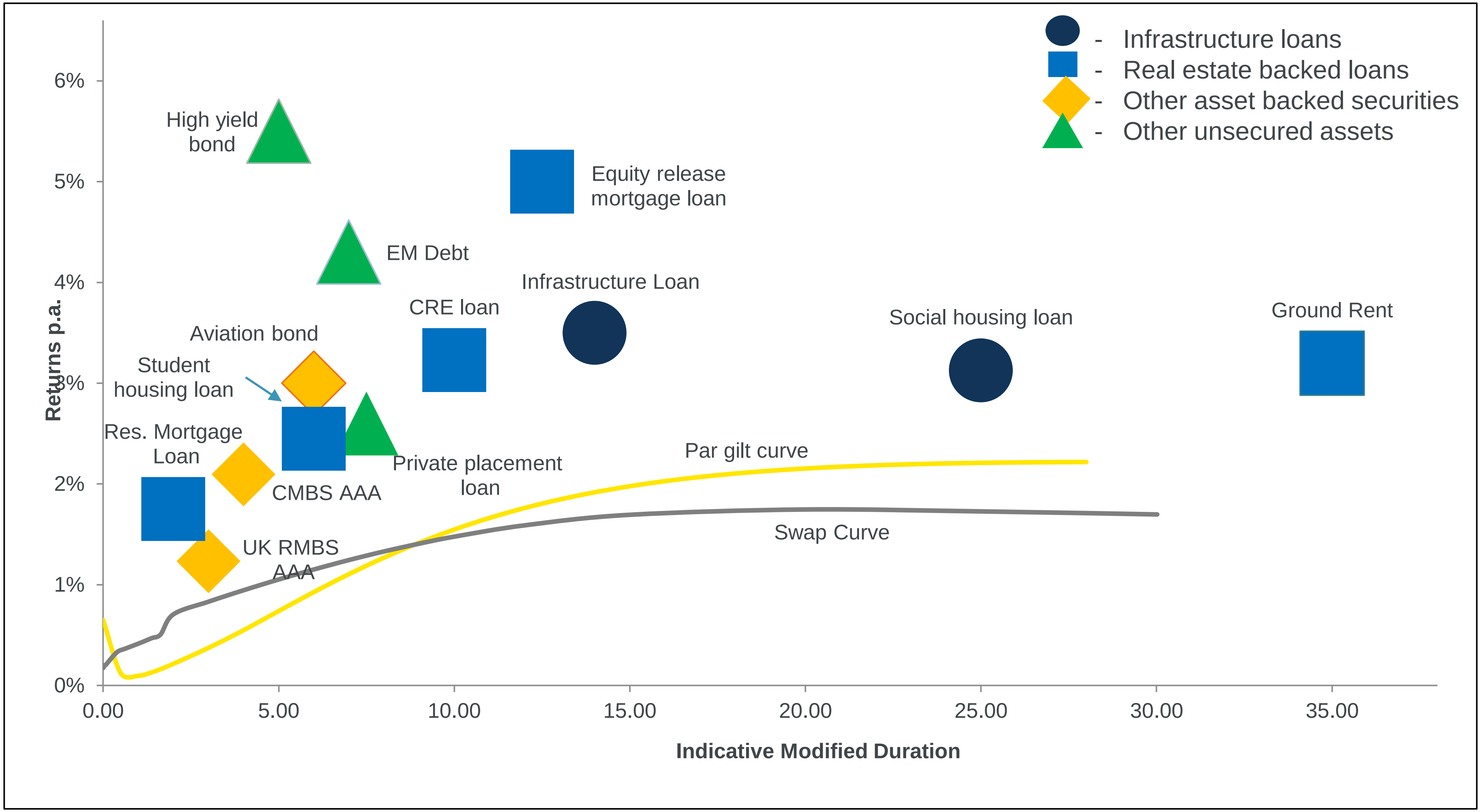
Source: Markit

FTSE 100 historical data

Recent volatility in the equity market

Source: https://uk.investing.com

The search for yield continues amidst a challenging economic backdrop



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Key investment strategy considerations

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Key investment strategy considerations

Issues facing insurance companies:

Margins are low, in part due to low investment returns

Insurers are taking on more risk through their investment portfolios

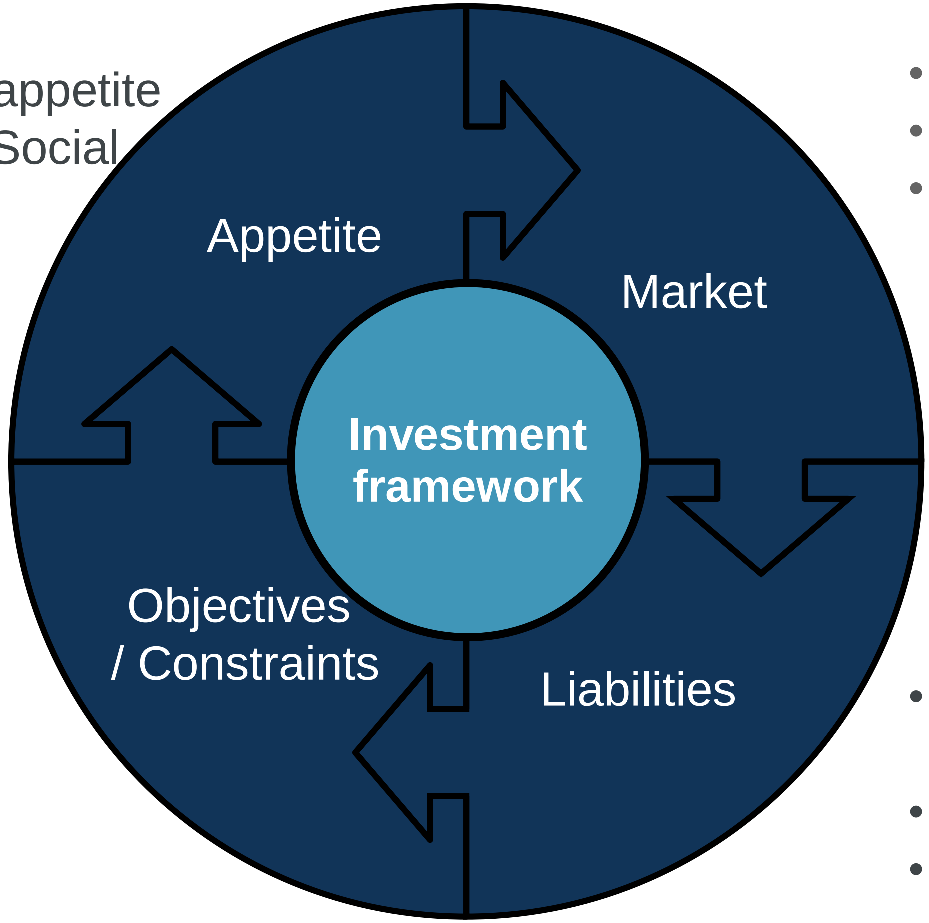
Balance sheets are increasingly complicated with a number of sometimes conflicting metrics

Asset optimisation has been largely limited to the "low hanging fruit" (e.g. moving to illiquid assets in annuity funds).

Key investment strategy considerations

- Investment risk appetite
- Environmental, Social and governance
- etc.

- Current returns
- Investment opportunities
- etc.



- Solvency ratio
- IFRS profits
- etc.

- Matching adjustment eligibility
- Equity backing ratios
- etc.

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Key questions to assess the effectiveness of your strategic asset allocation

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How do you choose between investments?

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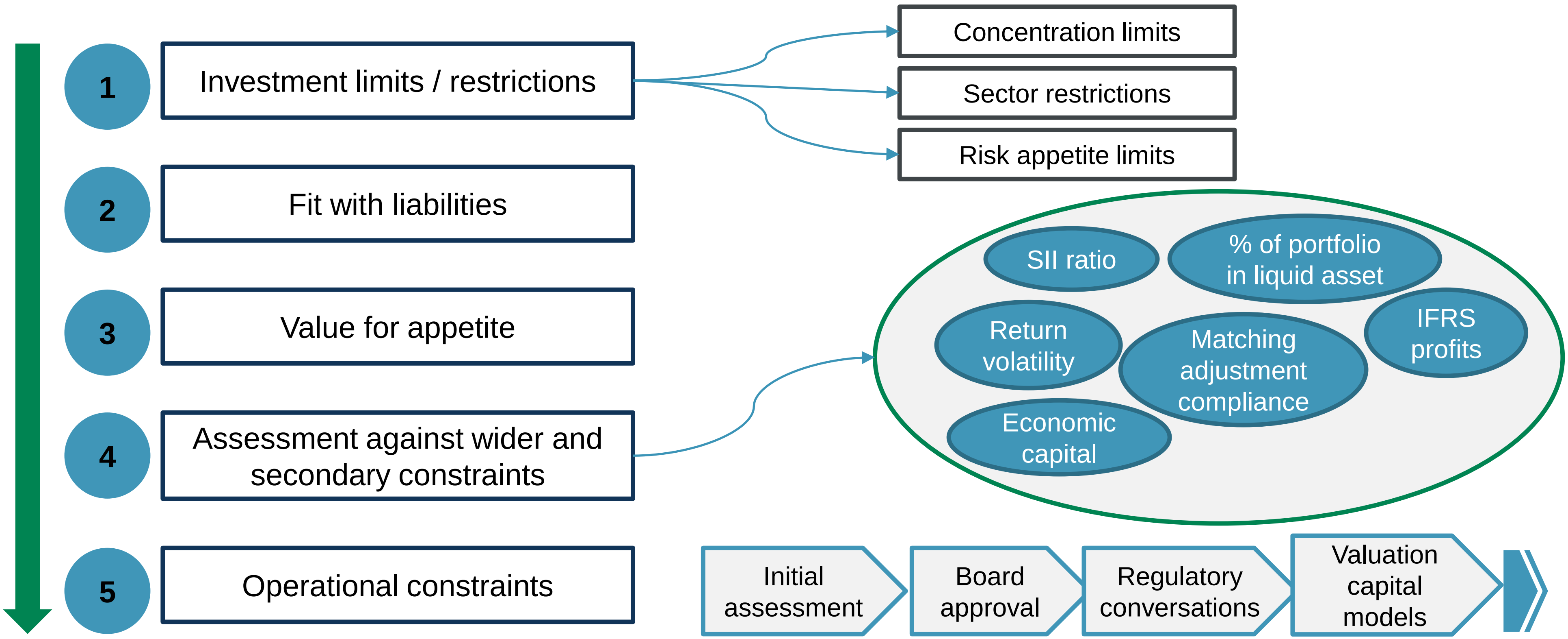
How do you choose between investments?

Understanding the question and key considerations

- Being able to effectively and efficiently determine when an asset is good value, appropriate relative to your existing investment portfolio and in line with your risk appetite is crucial
- Key considerations when choosing between investments might include the following:



How do you choose between investments?

An indicative example of how this may translate in reality

1	**Current situation**	• Significant investment risk taken in surplus assets • Limited investment risk taken in assets explicitly backing liabilities (i.e. mostly government bonds)
2	**Should risky assets be used back liabilities?**	• Step through process outlined on previous slide • Key considerations will be whether risk is more or less rewarded backing liabilities
3	**Do we need to go through whole process for every decision?**	Can use following approaches to streamline process: • Strategic Asset Allocation ("SAA") / Tactical Asset Allocation ("TAA") approach • An investment risk appetite which captures limits These are used within wider limit monitoring process

1. Investment limits / restrictions
2. Fit with liabilities
3. Value for appetite
4. Assessment against wider and secondary constraints
5. Operational constraints

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How do you know your asset allocation is providing you with the best return on risk?

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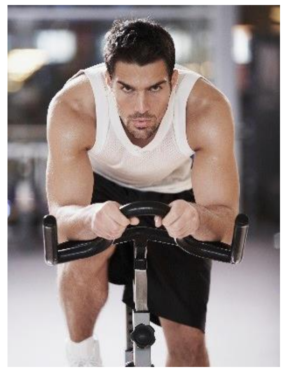
How do you know your asset allocation is providing you with the best return on risk?

Understanding the question and key considerations

1 Do you know the entire asset universe that you have available to you? Could there be any new asset classes or sectors for your firm to explore?

2 How frequently do you perform a fundamental review of the constraints imposed on your asset selection? Could some constraints be relaxed, removed or refined?

3 Have you considered optimisation techniques to make your assets work harder? Could you generate additional yield from your existing portfolio?



How do you know your asset allocation is providing you with the best return on risk?

An indicative example of how this may translate in reality

- A possible approach is to consider each liability business unit and whether the investment strategy adopted for each unit is conservative, typical or aggressive (relative to other market participants).

Business line	Conservative approach	Typical approach	Aggressive/ advanced approach
Annuities	Vanilla assets (e.g. government bonds)	Corporate bonds and infrastructure debt	Illiquid assets
Unit-linked	Specify a SCR ratio limit Hedge the market risk in the PVFP using derivatives	Insurer has no market risk exposure over and above that introduced through AMCs	Unit matching
Participating business	Hold to maturity (HTM) bonds Interest rate and duration swaps for risk mitigation	Same as conservative but with limited use of derivatives	Transfer HTM assets to an SPV owned by insurer in exchange for equivalent income without realising a gain

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Conclusion: An integrated investment framework which captures wider business constraints and strategy

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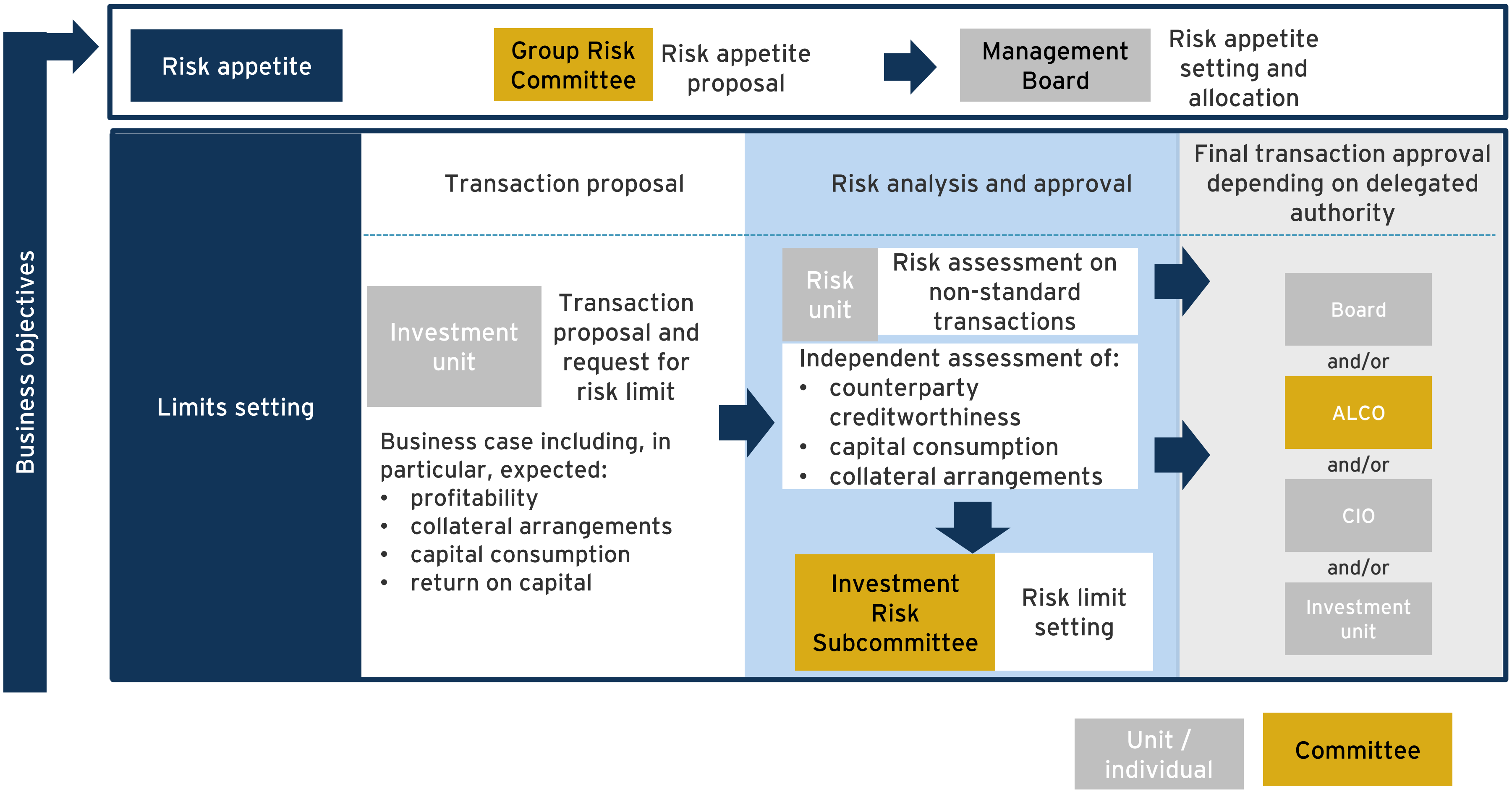

Questions

Comments

Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

The views expressed in this presentation are those of the presenter.