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The Macro-Economic Environment: The Backdrop to Insurance Companies' Investment Strategies

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Agenda

- Challenges in the current economic and regulatory environment
- The impact on insurers' investment strategies
- How insurers can successfully navigate the current economic environment



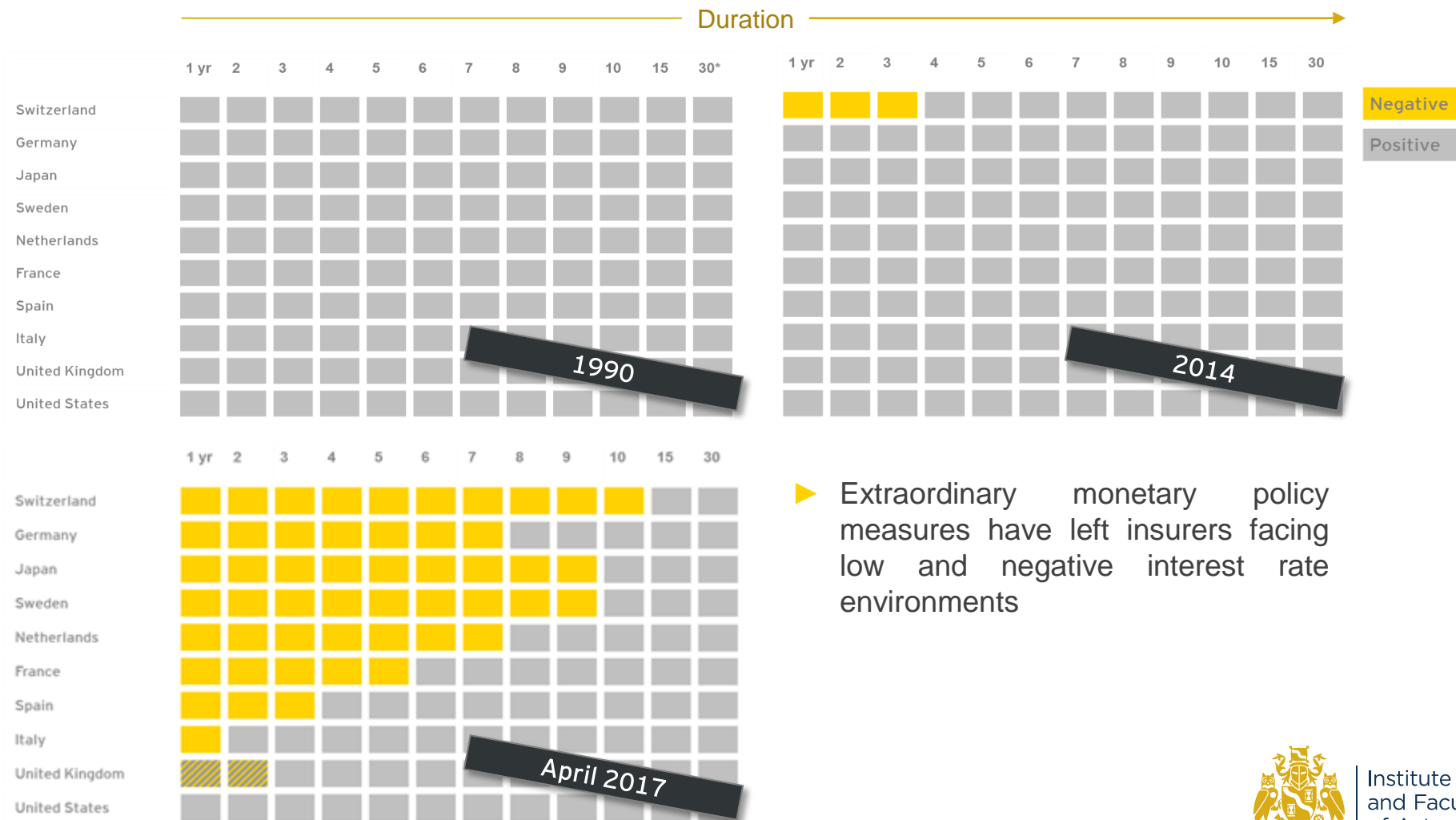


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Challenges in the current economic and regulatory environment

29 April 2017

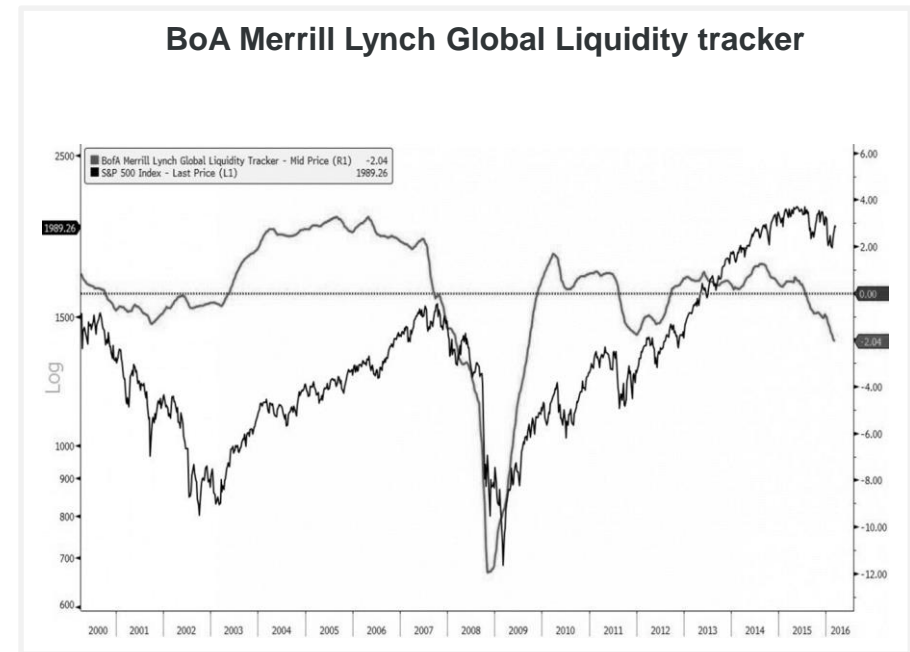
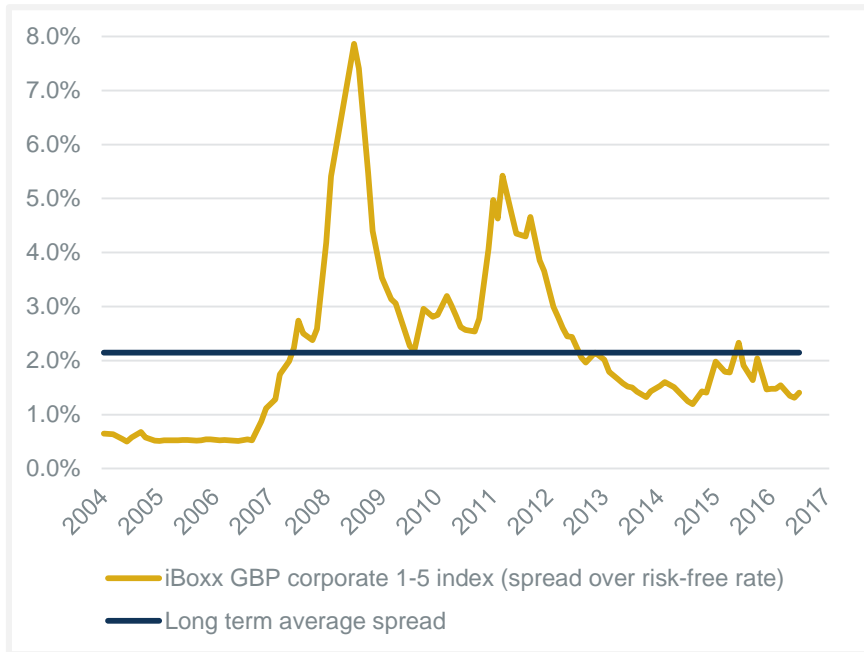
Government bond yields are (still!) at all time lows



▶ Extraordinary monetary policy measures have left insurers facing low and negative interest rate environments



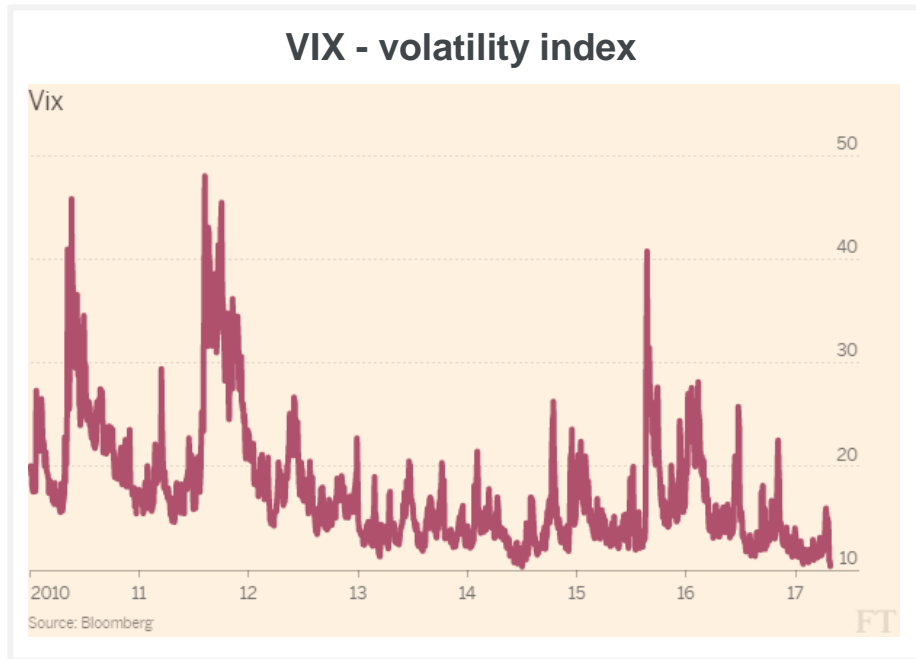
Spreads and market liquidity are lower than historical averages



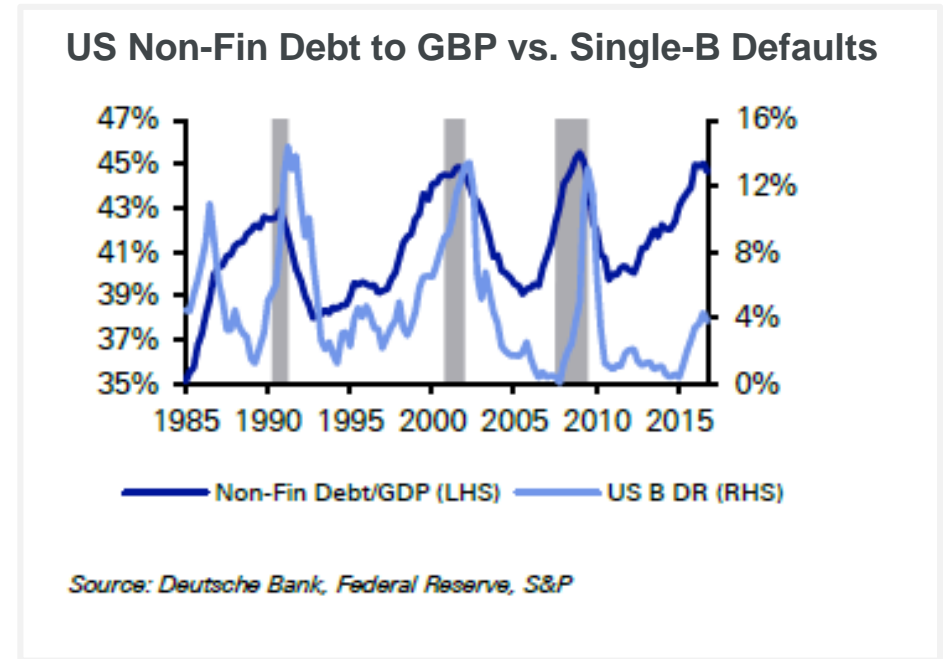
► Strong investor demand for yield has meant credit spreads have remained narrow.

► Demanding central bank bond purchasing programmes and banking regulatory strictures have impacted bond market liquidity

While investors are worried about volatility, there may be other issues to worry about...



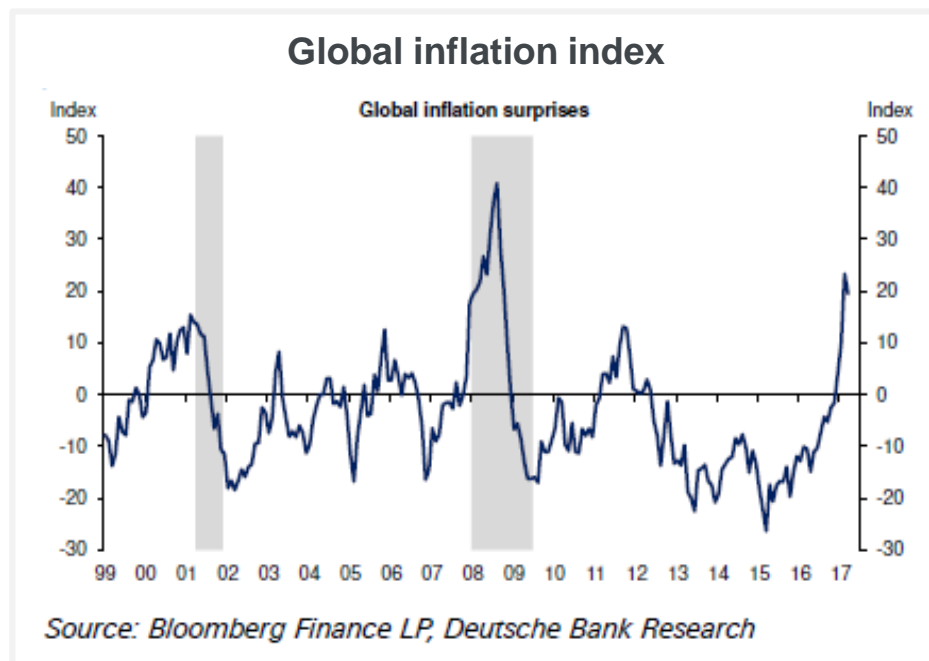
- ▶ Despite a large focus on volatility, based on the VIX, the actual levels of volatility are fairly low.



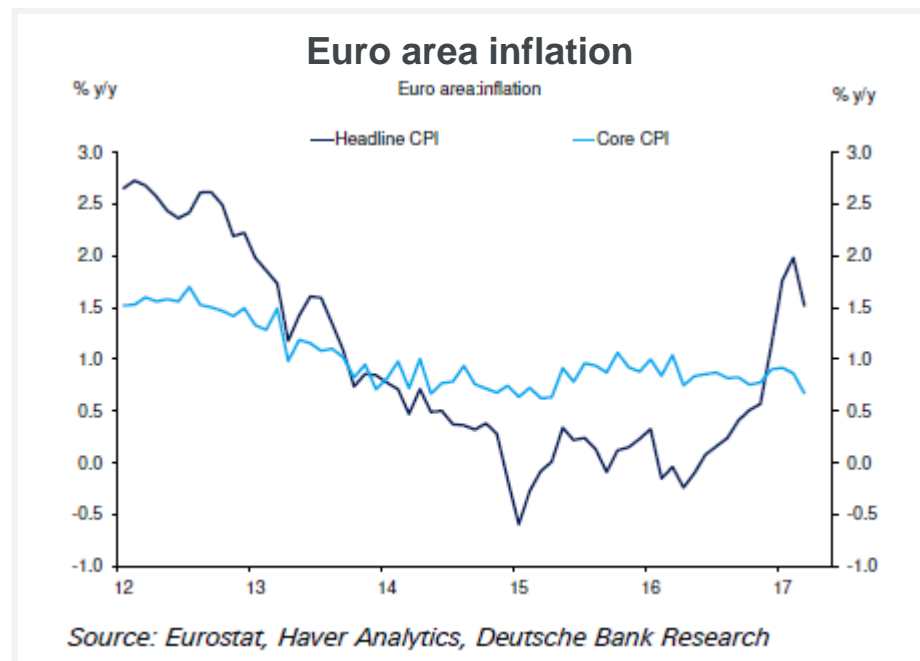
- ▶ Corporate leverage is at the levels, and has seen the pace of growth, consistent with the periods leading up to the last three recessions.



Inflation is on the rise...



- ▶ Global inflation has seen a sharp increase over the last year



- ▶ Inflation has also picked up across Europe which could act as a drag on real GDP growth



Political and economic events have caused market disruption and there may be more to come...

Over the last few years, a number of political and economic events have increased market volatility

Brexit vote



US election result



Euro crisis



Future political events are likely to drive further volatility within financial markets and the economy

Brexit negotiations



French election

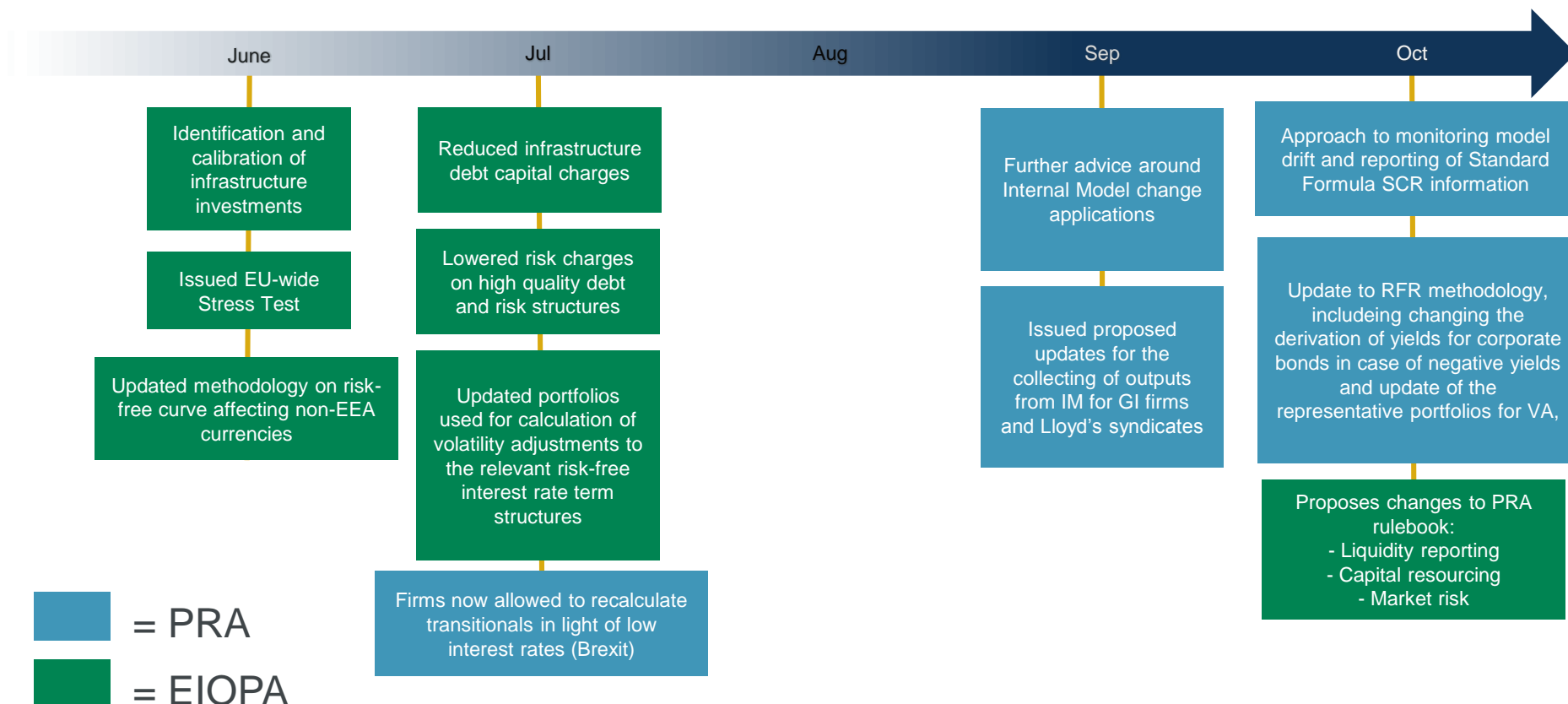


Trump's tax reform



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The PRA and EIOPA have also kept insurers busy post-implementation of Solvency II..





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The impact of volatility on insurers' investment strategies

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Investment trends as result of market volatility

Key Trends	Comments	Challenges
Diversification within fixed income	Increased yield <ul style="list-style-type: none"> ▶ From sovereign to credit ▶ From liquid to illiquid ▶ From local to global 	Depends on internal/external AM <ul style="list-style-type: none"> ▶ Availability of assets ▶ Structural challenges ▶ Operational complexity
Sophisticated equity strategies	Maintain equity upside with controlled downside <ul style="list-style-type: none"> ▶ Structured products e.g. controlled VaR products ▶ Capital protection products ▶ Wider use of risk mitigation techniques through derivatives 	<ul style="list-style-type: none"> ▶ Complexity of modelling ▶ Real advantages only come for internal model firms ▶ Not widely understood
Wider spectrum of RE	Insurers understand Real Estate risk; now build on this <ul style="list-style-type: none"> ▶ From residential to non-residential (and vice-versa) ▶ From direct to indirect investments ▶ From local to global 	<ul style="list-style-type: none"> ▶ Product variations in each market ▶ Avoiding securitisations ▶ Understanding other markets



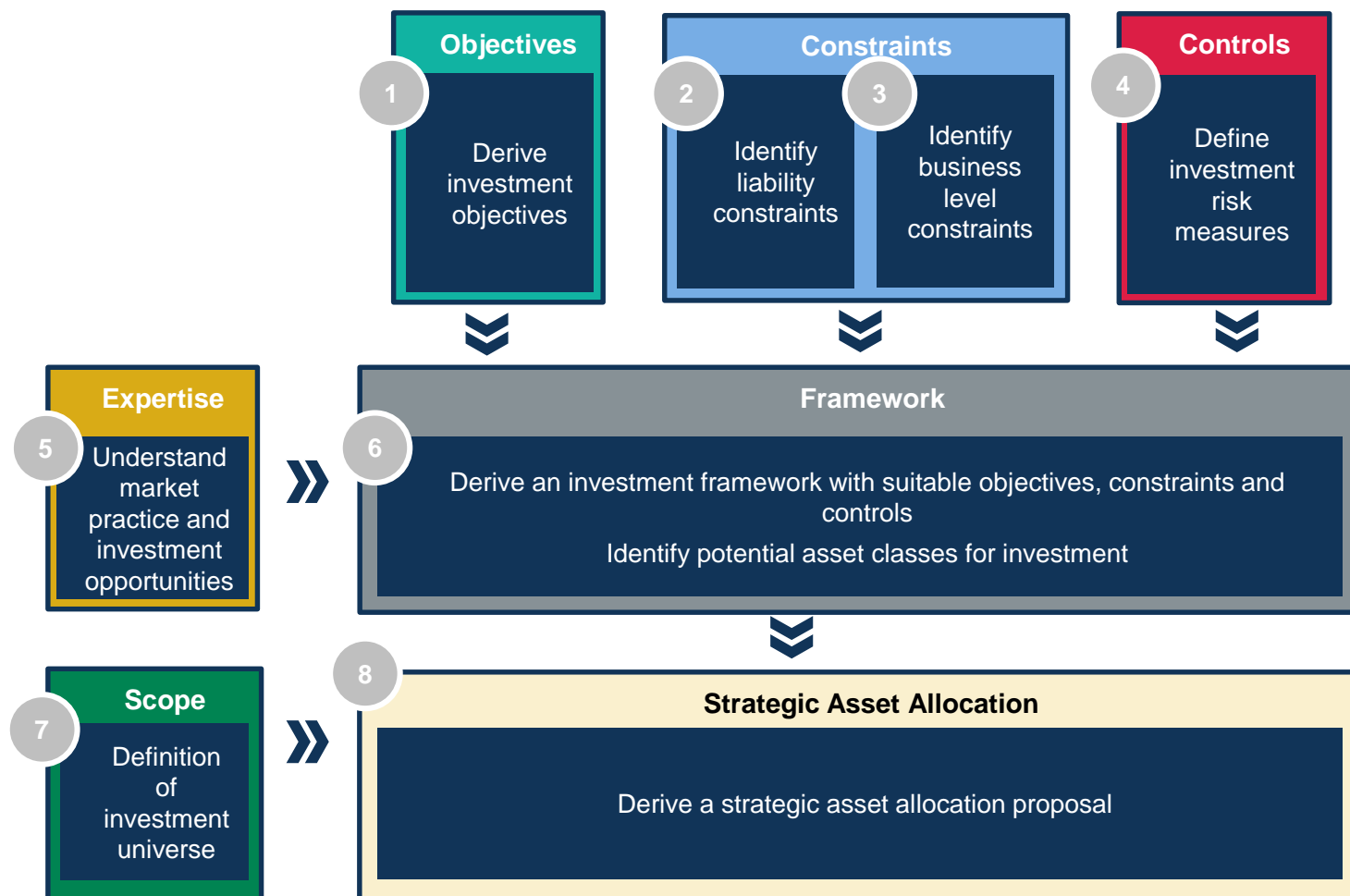


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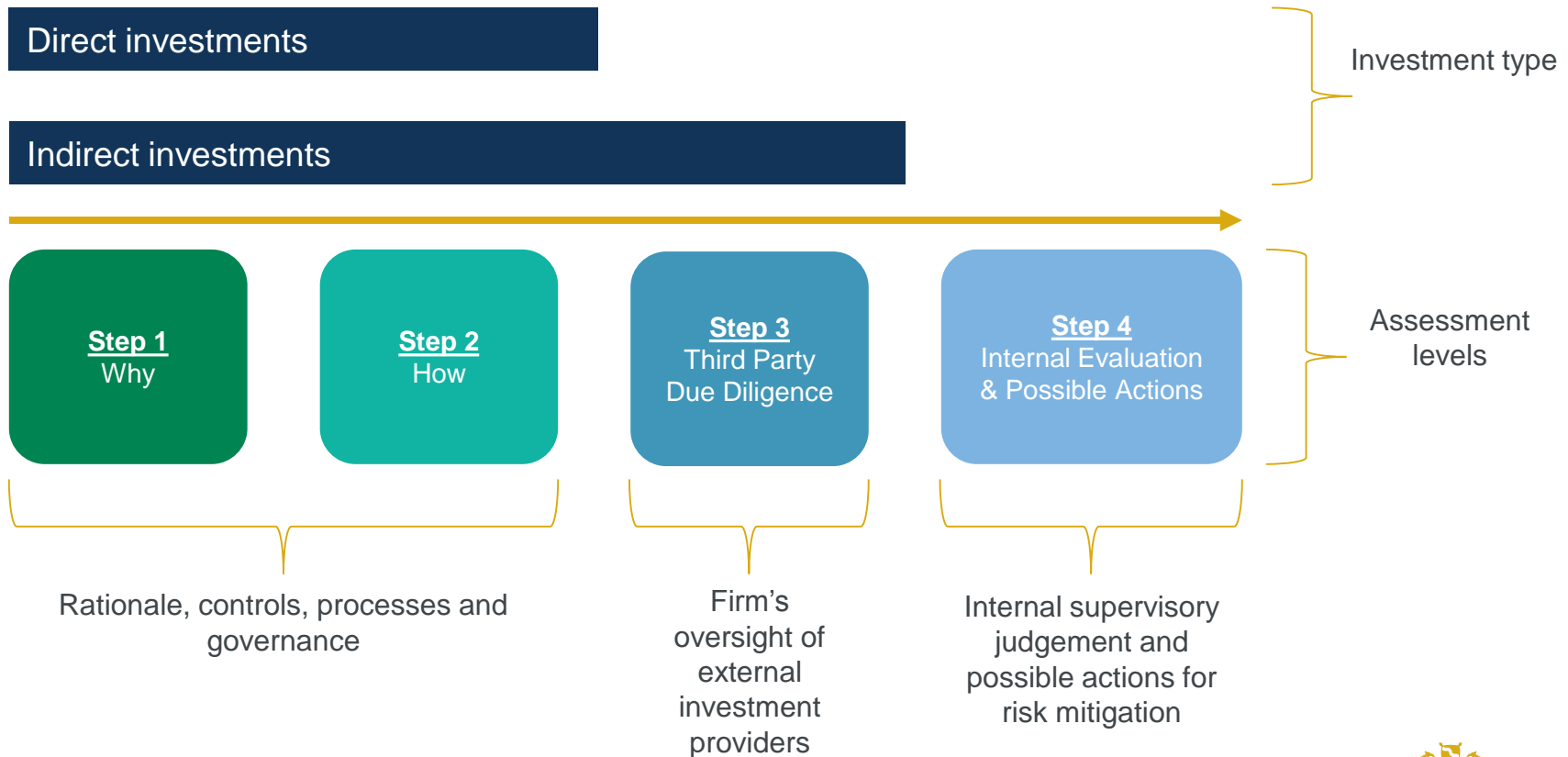
How insurers can successfully navigate the current economic environment

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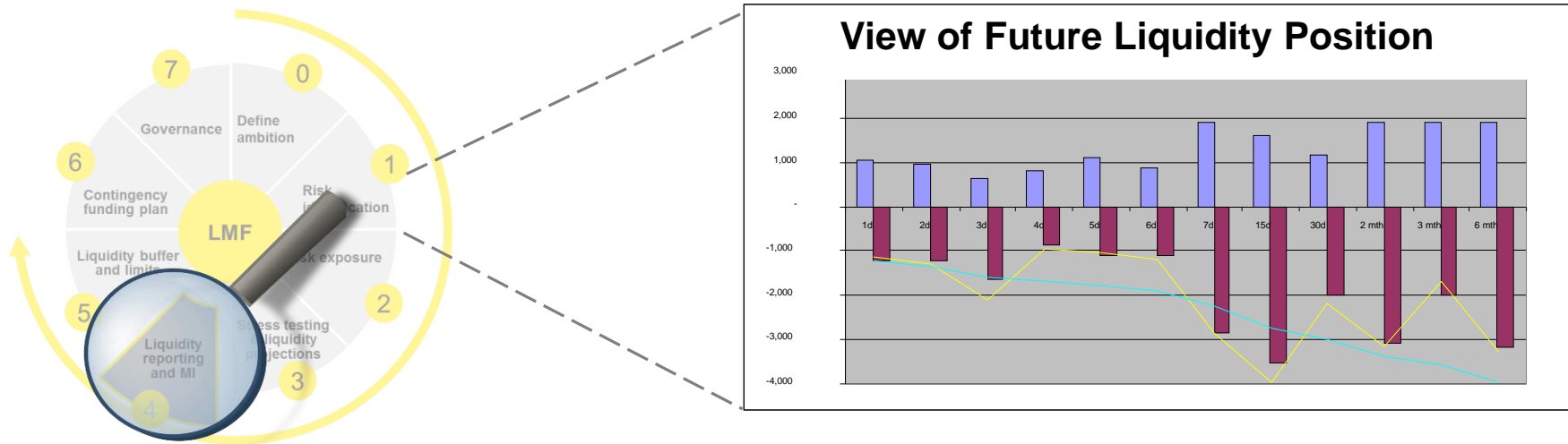
Approach to investment strategy



An effective investment governance framework can allow you to take advantage of opportunities as they arise



Robust liquidity management can protect insurer's in market crises and add value



- ▶ While insurers need to consider their obligations when managing liquidity, they can also consider potential opportunities
- ▶ Insurers can look to generate an illiquidity premium on assets which aren't needed to meet liquidity requirements
- ▶ Through consideration of a firm's liquidity requirements, liquid resources can be moved up the 'ladder of liquid assets'



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Concluding remarks

Conclusion

- Insurers need to adapt to the uncertain macro-economic environment
- Insurers need to balance investing to combat low yields against taking additional risk in order to meet return targets
- Volatile markets provide the opportunity for insurers with well-controlled and developed investment capabilities to create value and position themselves to generate an advantage



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.



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