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Enhancing your investment strategy in today's investment climate

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October 2017

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Contents

1. Backdrop to the current macro-economic environment
2. Key investment strategy considerations
3. Key questions to reflect upon when assessing the effectiveness of your strategic asset allocation
    - How do you choose between investments?
    - How do you know your asset allocation is providing you with the best return on risk?
4. Extended case study: enhancing your investment strategy
5. Conclusion

“A lack of clarity could put the brakes on any journey to success.”

Steve Maraboli, Behavioural Scientist

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Backdrop to the macroeconomic environment

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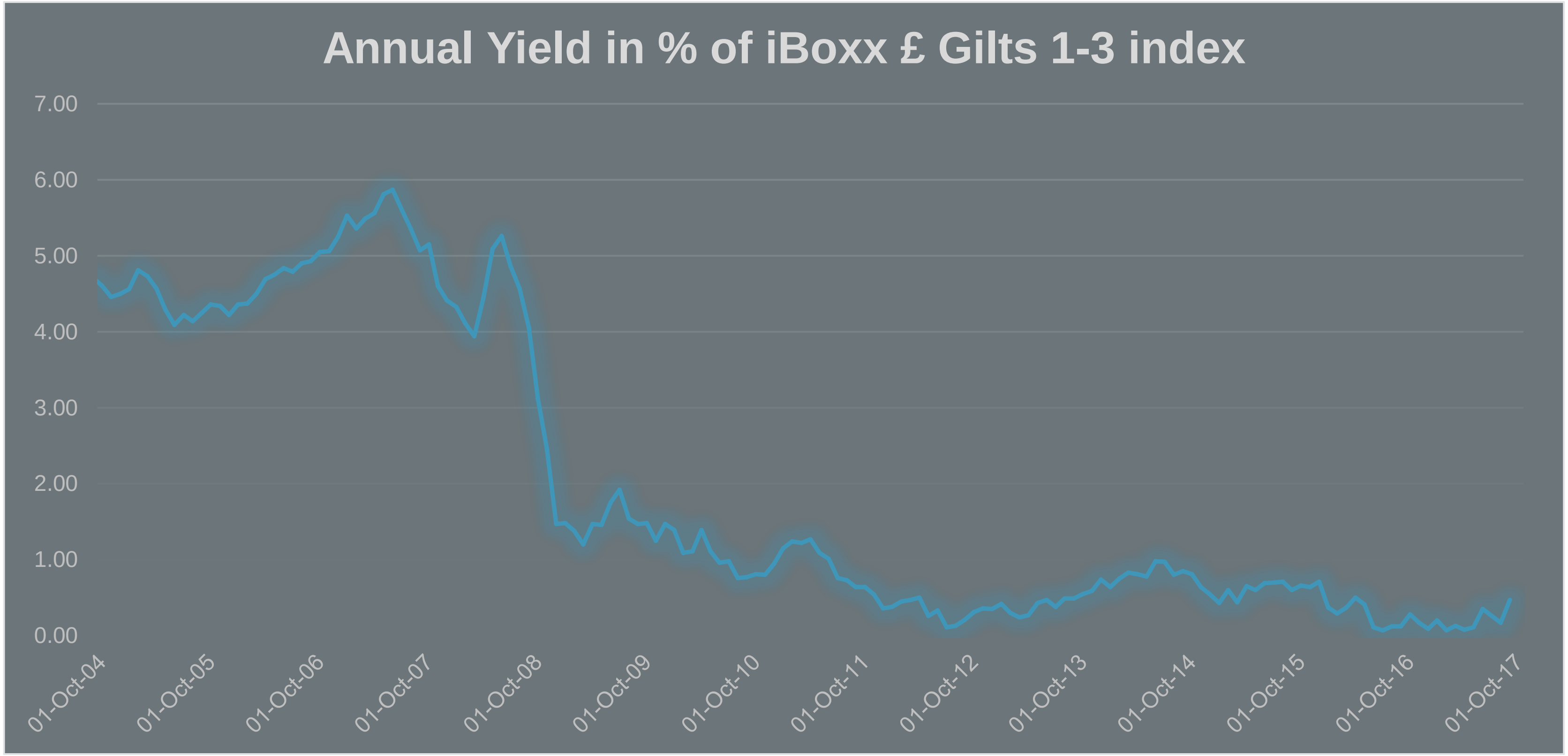
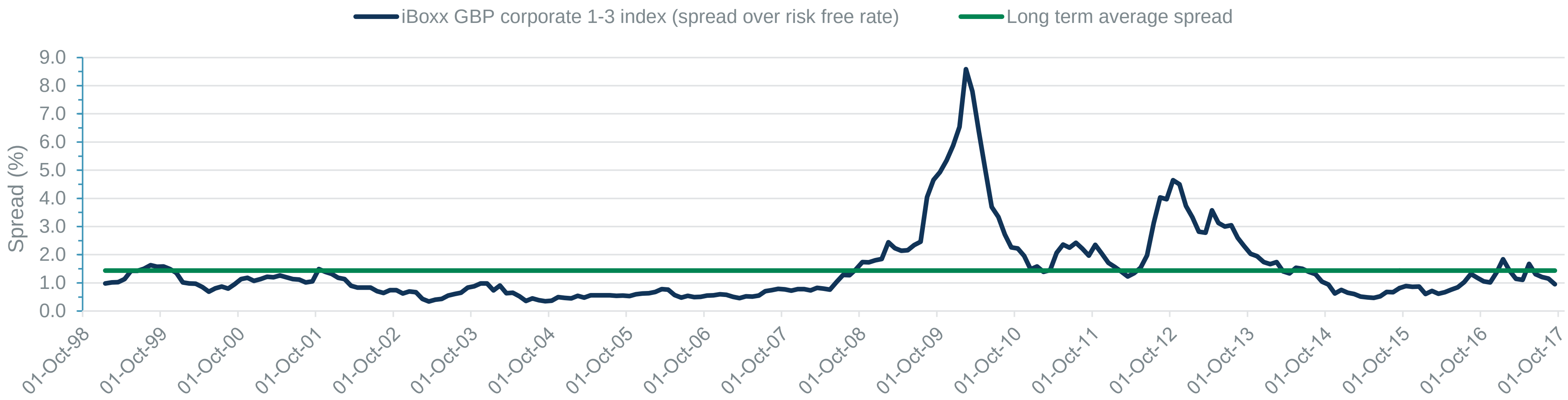
The search for yield continues amidst a challenging economic backdrop



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

Source: Markit, iBoxx £ Gilts 1-3 index

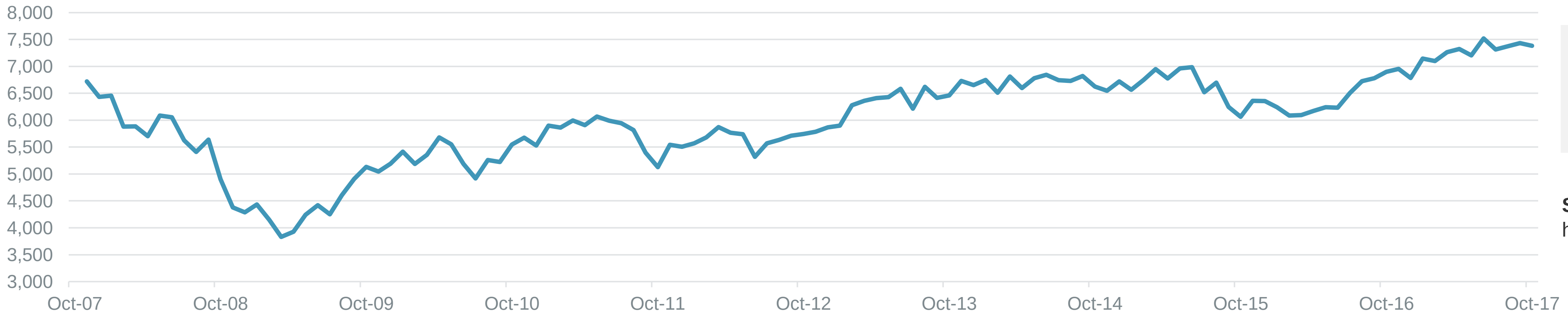
The challenging environment extends to both corporate bond and equity investments



Spreads are below long term averages

Source: Markit

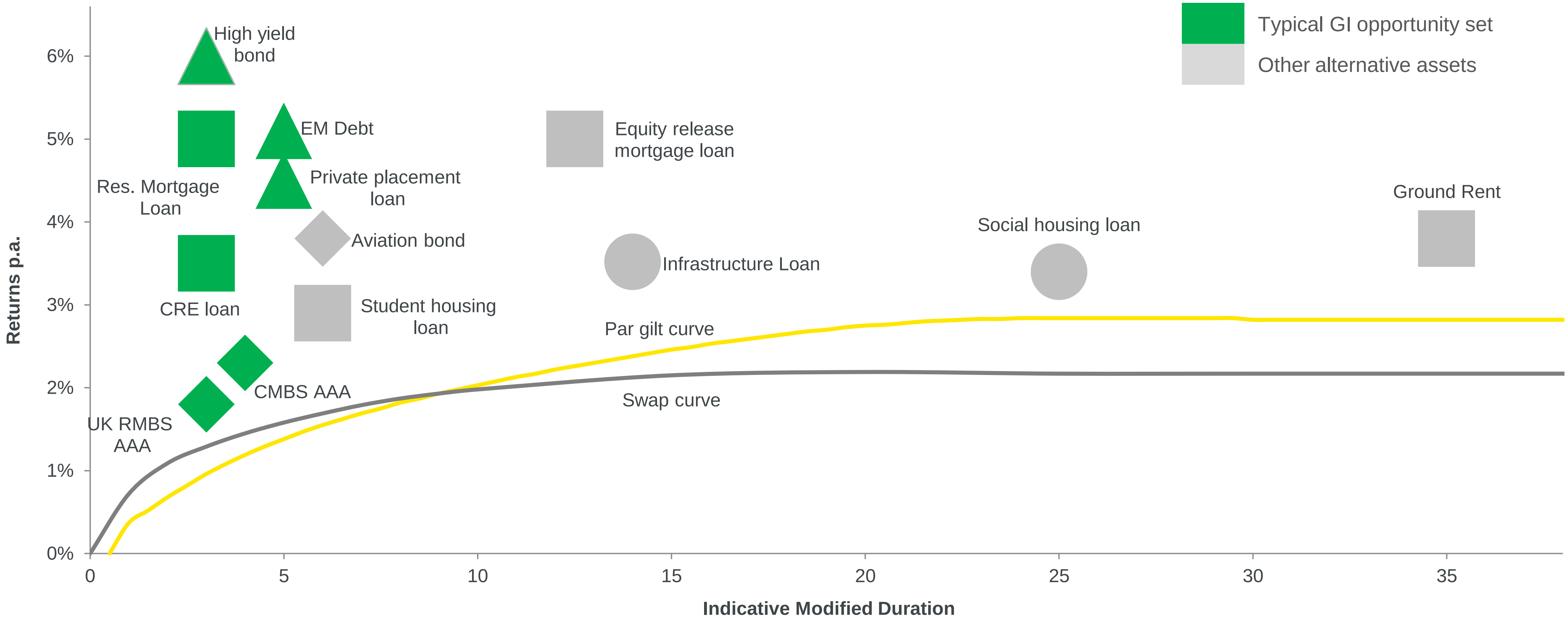
FTSE 100 historical data



A turbulent geo-political environment threatens recent strong equity returns

Source: https://uk.investing.com

But other opportunities exist for non-life firms to combat the existing climate



Source: EY with template from IFoA non-traditional working party

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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

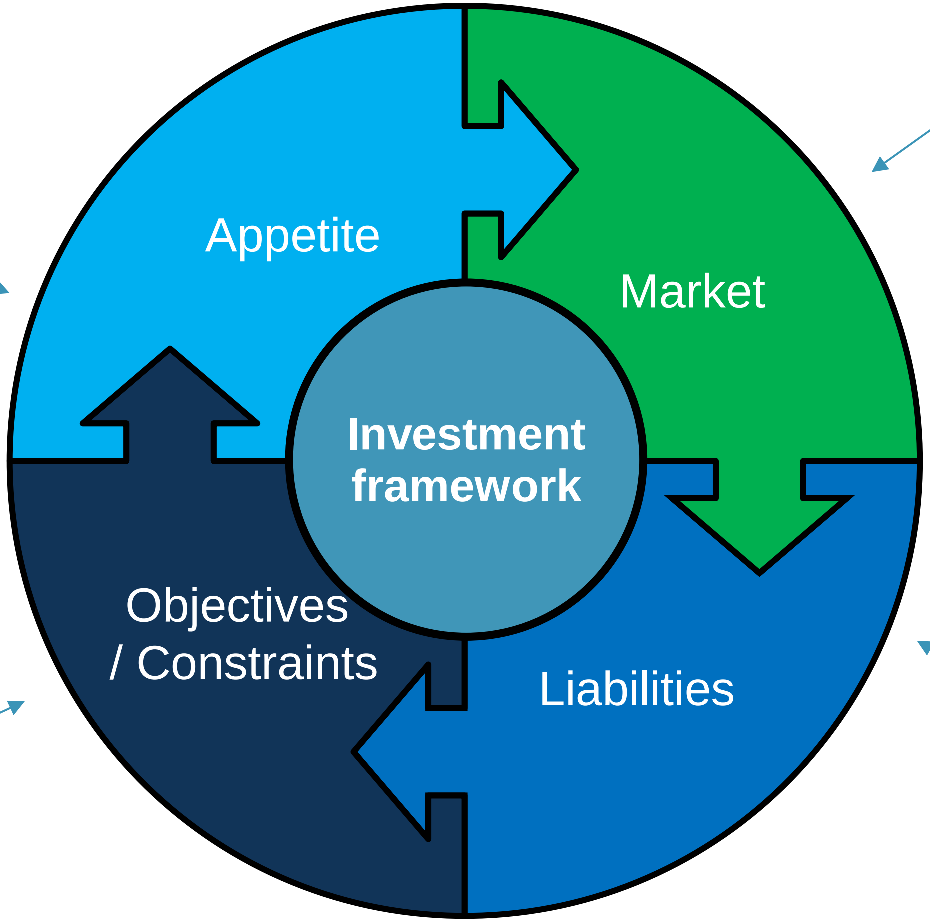
Balance sheets are increasingly complicated with a number of sometimes conflicting metrics

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 ("ESG")

- Current returns
- Investment opportunities



- Solvency ratio
- IFRS profits

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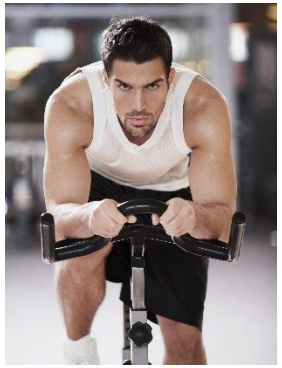
How do you know your asset allocation is providing you with the best return on risk?

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?

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How do you choose between investments?

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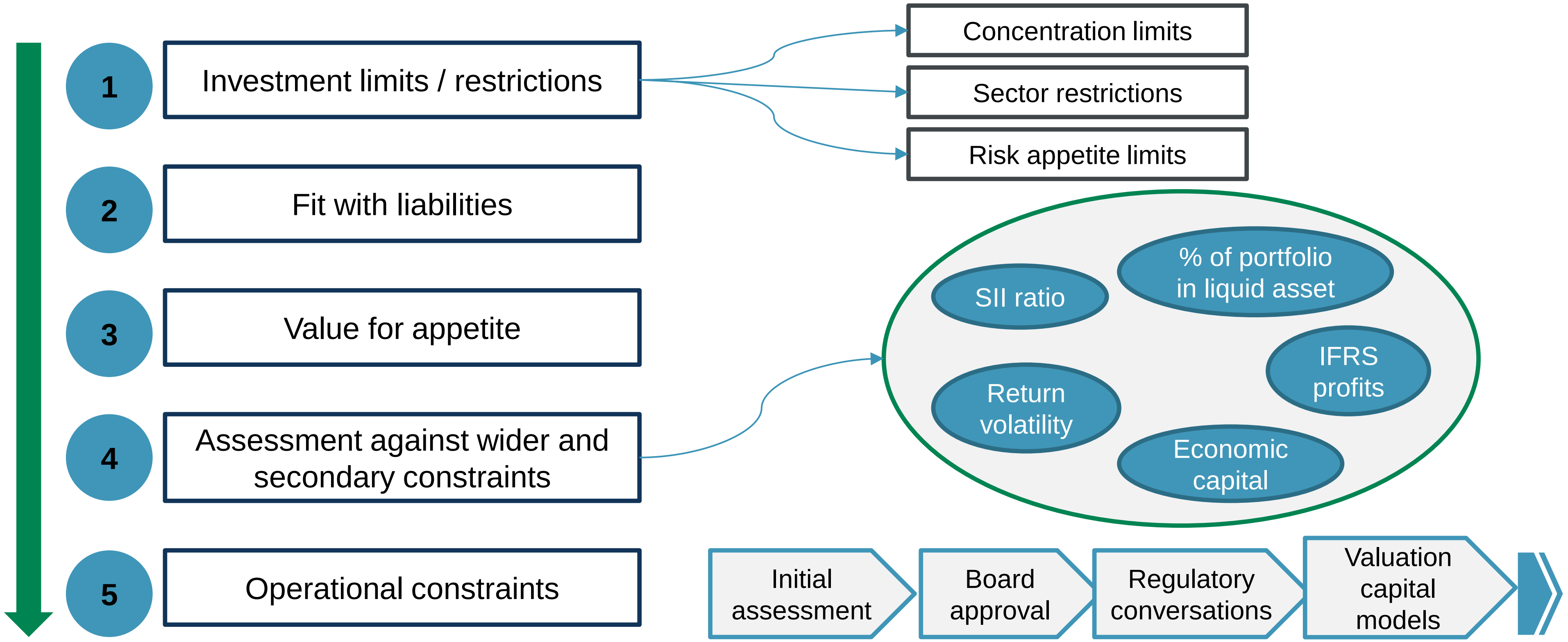
How do you choose between investments?

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:



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An extended case study: enhancing your investment strategy

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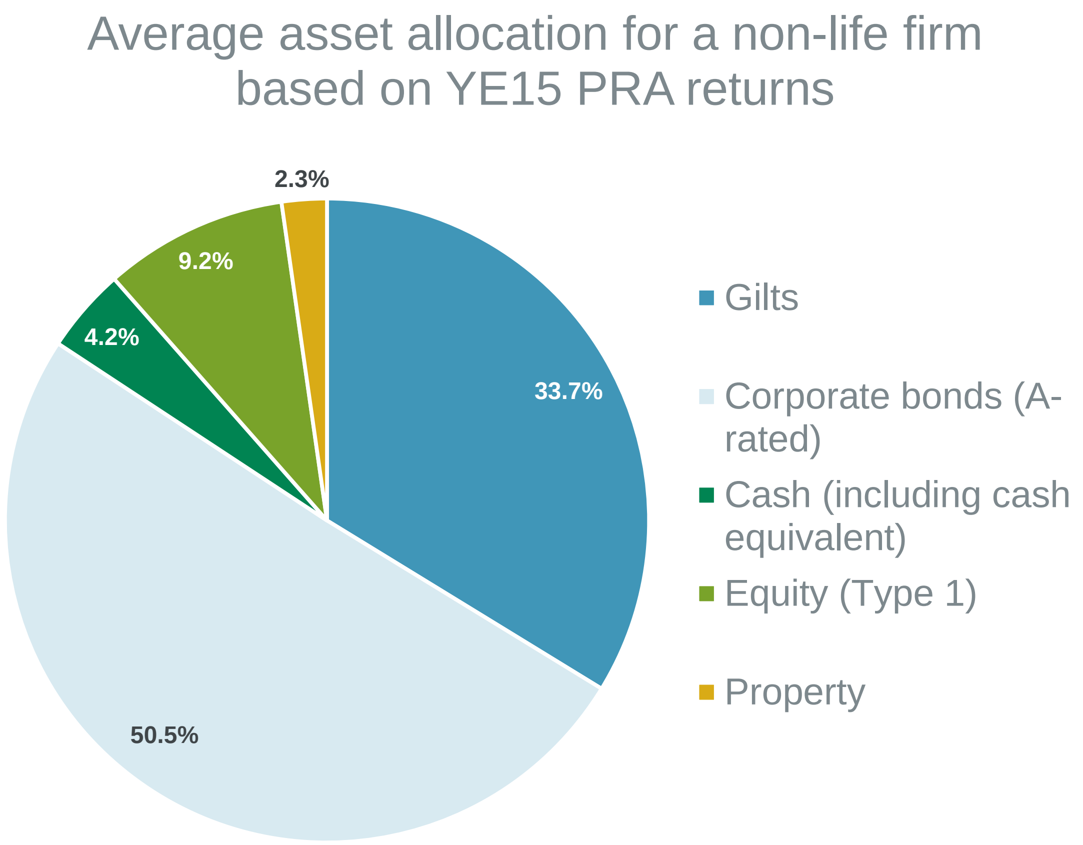
Extended investment strategy case study

High-level synopsis of a non-life firm



- We have assumed that the non-life firm has motor insurance liabilities, with duration of one year.
- The average asset allocation does not include allocation to CIS, derivatives, investment pools, inadmissible assets and "other", for simplicity.
- We have assumed that investments in government bonds are entirely in gilts, for simplicity

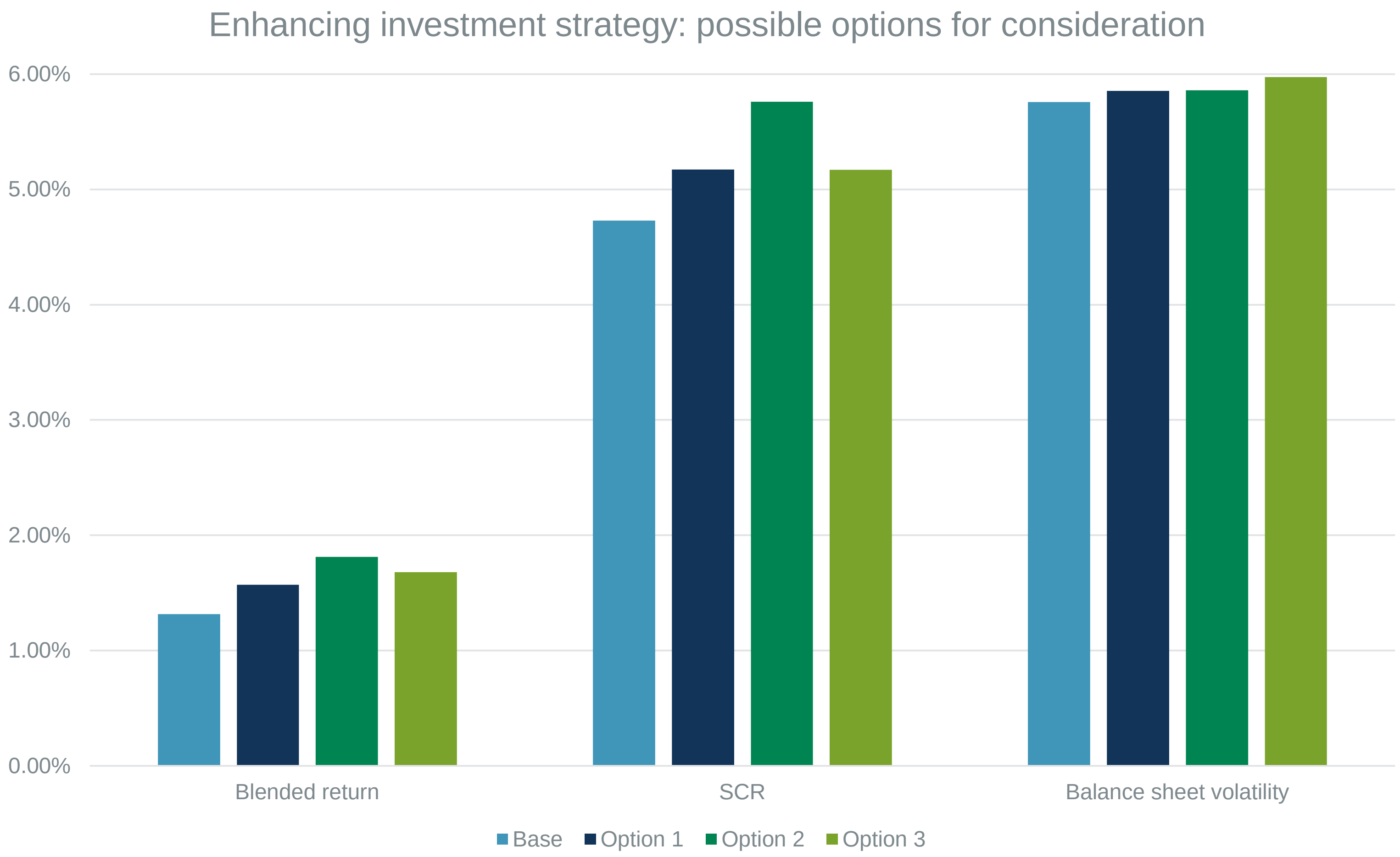
Extended investment strategy case study

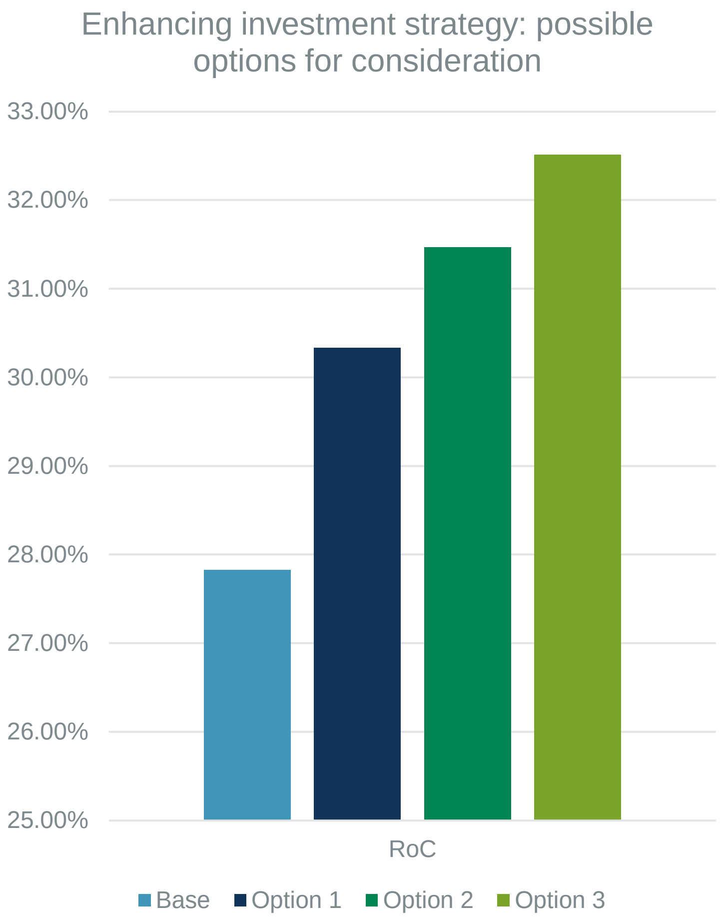
Possible options for consideration

	Base	Option 1	Option 2	Option 3
Allocate assets as per “average asset allocation” (c.90% in cash, government bonds and corporate bonds)	✓			
Switch c.15% from bonds to short-dated qualifying infrastructure debt		✓		
Maintain c.75% of assets in cash, government bonds and corporate bonds			✓	✓
Balance sheet volatility constraint and allow SCR to vary			✓	
SCR constraint and allow balance sheet volatility to vary				✓

Extended investment strategy case study

Output of option implementation





Questions

Comments

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Conclusion

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Enhancing your investment strategy in today's investment climate

- Insurers need to understand their **entire asset universe** and also **how they make investment decisions.**

- Insurers need an **effective investment framework** to clearly articulate risk measures / objectives / constraints, in order to make informed investment decisions.