Achieving long-term, capital efficient growth for Insurers

Simon Richards FIA
Insight Investment

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Agenda:
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• Managing assets for insurers
• Why equities?
• Introduction to Diversified Growth strategies (DGS)
• Risk analysis and performance
• DGS within a regulatory framework
• Conclusions
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Abstract

Key points:
1. Risk assets such as equities are expected to provide attractive returns over the long-term but can show significant volatility at certain times and are subject to large drawdown events
2. Protection strategies can be used to mitigate some of the downside risk but often cause a significant performance drag

Presentation:
– We take a closer look at diversified growth strategies which aim to actively allocate between asset classes to provide the benefits of diversification whilst seeking to mitigate against significant downside events
– We discuss the practical problems for insurers seeking to monitor these strategies, including the complex exposures and the appropriate regulatory treatment
Managing assets for insurers

1. Liquidity management portfolio: Cash flow management
   - Managing day-to-day and unexpected cash flows
   - Money market funds

2. Core portfolio: Liability management
   - Facilities tailored to clients' liabilities and objectives
   - Low yield environment means need to increase risk profile

3. Growth portfolio: Volatility management
   - Capital efficient long-term growth with low volatility
   - Increased diversification and capital efficiency
   - Portfolio tailored to client's liabilities and objectives
   - Low yield environment means need to increase risk profile

Why equities?
- Asset class performance 1998-2018, using suitable proxies for:
  1. Cash (USD)
  2. US bonds
  3. US TIPS
  4. US high yield
  5. Emerging markets (USD)
  6. US equities
  7. Developed market equities
  8. Emerging market equities
  9. Commodities
  10. Property
Introduction to DGS

Core principles

- Diversification across asset classes
- Active management across asset classes over time
- Reduced volatility and more stable outcomes for insurers

DGS seek a more stable growth profile

- The challenges of equity investment:
  - Dependence on a narrow set of drivers of return
  - Reliance on market direction to be the primary driver of returns
  - Dependence (limited) diversification to help protect downside
  - Long-term outcome highly variable based on timing
  - Inherent volatility built into strategy
Introduction

Variations of DGS

- Blending ‘traditional’ risk premia with alternative sources of potential return provides:
  - a broader opportunity set from which to generate potential return
  - greater diversification than being reliant on either one on its own

Introduction to DGS

Investing across a broad opportunity set

Example DG strategy

Targeting attractive returns

- Disciplined strategy offering flexibility, transparency and rigorous risk control

Please refer to the risk disclosures at the back of this document.

As at 28 February 2018. No investment strategy or risk management technique can guarantee returns or eliminate risk in any market environment.
Diversified sources of risk
Portfolio risk profile

Dynamic asset allocation
Asset allocation can change significantly over time

Example DG strategy
Targeting a smoother journey towards cash +4% (pa) returns
DG strategy performance characteristics

Peak to trough analysis

- How has the DG strategy behaved during large global equity market declines? (defined as falls in excess of 5%)
- The dynamic asset allocation of DG strategy steers investments away from poorly performing assets, helping reduce drawdowns
- There is a high 79% R² between MSCI World peak to trough declines of 5% or more for the past 10 years suggesting a high correlation between large equity market falls and negative returns in the strategy
- However, the extent of the DG strategy declines is much reduced
- As the chart opposite illustrates, the slope of the trend line between equity market declines and DG strategy declines ‘only’ has a slope of 30%–Over the 19 occasions in the last 10 years that we have experienced these large declines, our sensitivity has averaged 30%

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Source: Bloomberg and Insight Investment as at 4 October 2017. Declines are measured as peak to trough for the MSCI World and for an example DG strategy separately to maximise declines and provide an unbiased comparison. * R-squared is a statistical measure of how close the data are to the fitted regression line. 0% indicates that the model explains none of the variability of the response data around its mean. 100% indicates that the model explains all the variability of the response data around its mean.

Example DG strategy: Solvency II SCR analysis

Multi-asset low volatility strategy
Supporting our insurance clients

Conclusions

- Equities have the potential to produce attractive returns, particularly over the long term.
- However, equity return distributions have long tails:
  ...and annual returns can be volatile from year to year.
- There is significant drawdown risk in the short term:
  ...which might be reflected in regulatory / rating agency / risk capital models.
- Diversified Growth strategies aim to produce similar long-term returns to equities:
  ...but with lower volatility and reduced downside risk.
  ...by investing in a much more diversified portfolio.
  ...and actively managing the allocations over time.
  ...and which has the potential to deliver better returns on a risk-adjusted basis.

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.
Biography

Simon Richards, FIA – Head of Insurance Solutions

Simon joined Insight’s Financial Solutions Group in June 2008. He is now Head of Insurance Solutions in the Client Solutions Group and has overall responsibility for the design, implementation and monitoring of investment strategies for insurance clients.

Simon works closely with the relevant portfolio managers to ensure that the investment solutions are aligned to the needs of each client and remain efficient and appropriate given changing market conditions and evolving regulatory requirements. He began his career in 1994 and has held actuarial positions with Pearl Group and at JP Morgan, where he was responsible for structuring derivatives solutions to UK and European insurance companies.

Simon holds a BSc (Hons) in Mathematics from the University of Exeter and is a Fellow of the Institute of Actuaries in the UK.

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