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Investment Challenges for Small(er) Insurers

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Agenda

- Setting investment objectives
- Defining risk appetite
- Balancing risk, return and capital
- Meeting regulatory requirements
- Practical implications of strategy implementation



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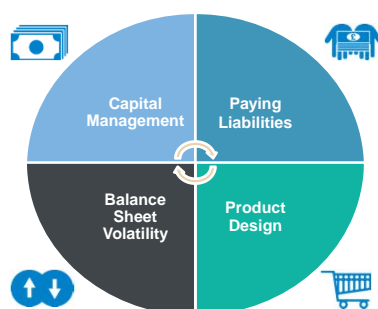
Setting Investment Objectives

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Business Considerations

- Capital charges
- Capital efficiency
- Cost of hedging

- Equity and credit spread market risk
- Capital charge volatility
- Cost of hedging



- Cashflow matching
- Low bond yields, low reinvestment rates
- Less predictable cash flows

- Meeting investment hurdle rates to stay competitive
- Aligning products with customer appetite
- Reducing margins



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Investment Objectives



Improve Risk management

- Actively asset management to manage market volatility
- Risk mitigation techniques to control volatility and downside risk



Increase Diversification

- Broaden our asset exposures, to capture correlation benefits from a global opportunity set



Capital Allocation

- Does our portfolio represent working capital/surplus funds?
- How much capital is allocated to portfolio?



Enhance Yield

- Find new sources of stable cash flows
- Harness the illiquidity premium in markets



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Defining risk appetite

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Risk Appetite Definitions

How much can you afford to lose?

Solvency Ratio

Stakeholder's
expectation

Maximum Loss	Example - Maximum annual reduction in surplus assets we can accept is £X m?
Volatility	Example - 5% volatility target: the range of the asset value is expected to have a standard deviation of 5%
Value at Risk	Example - 95% VaR target: the maximum loss we can accept is £Y m in a one in twenty year scenario



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Balancing risk, return and capital

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Investment Building Blocks

CASH

- Money-market strategy
- Same day liquidity
- **A buffer for liability backing and surplus assets**

LIQUIDITY

Fixed Income

- Liability matching
- Focused on generating a positive return, but with capital preservation a priority
- **To secure the liabilities with a high degree of confidence**

LIABILITY

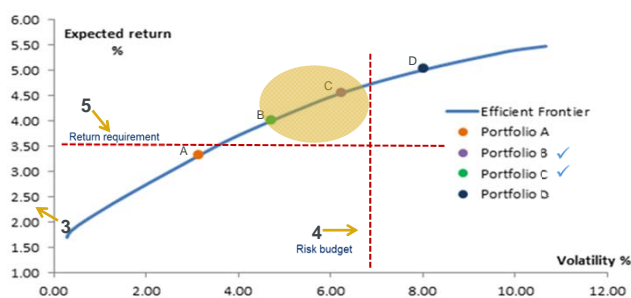
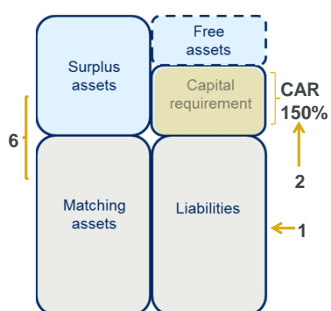
Growth Assets

- Captures the higher returns available from growth assets
- Risk managed
- **To generate capital growth**

GROWTH



Asset Allocation Exercise



Source: Schroders, for illustration purposes only



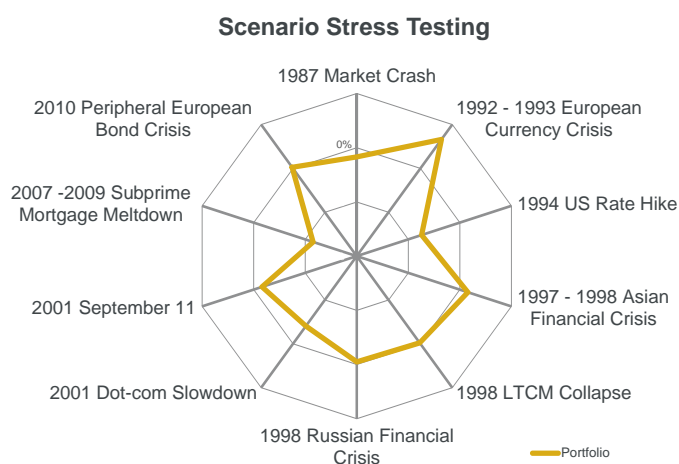
Return vs Risk

- Maintain separate and distinct liability and growth portfolios
- Target $x\%$ annual expected return
- Volatility of $y\%$ p.a. in the growth portfolio
- Loss tolerance of $z\%$ portfolio, risk budget 95% one year VaR
- High level of liquidity through the market cycle
- Risk adjusted return



Source: Schrodgers, for illustration purposes only

Scenario Stress Testing



Source: Schrodgers, for illustration purposes only

Execution and Market Timing



- What is the time horizon?
- What is the market trading level on investment date?



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Meeting Regulatory Requirements

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Prudent Person Principle

With respect to the whole portfolio of assets, insurance and reinsurance undertakings shall **only invest in assets and instruments whose risks the undertaking concerned can properly identify, measure, monitor, manage, control and report**, and appropriately take into account in the assessment of its overall solvency needs in accordance with point (a) of the second subparagraph of Article 45(1).

Data and Reporting

Standard Reports

- Valuation
- Performance
- Counterparty Exposure
- Quarterly Investment Report

QRT Reports

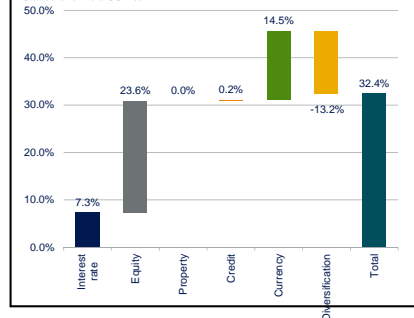
- D1
- D2
- D4

Tripartite Template **BVI** **SAM** **PERG** **afg** **ima**

id	code	description	category	status	date	value
Particulars: Derivatives and related						
1	Interest rate	Interest rate derivatives	Interest rate	Active	2016-10-31	7.3%
2	Equity	Equity derivatives	Equity	Active	2016-10-31	23.6%
3	Property	Property derivatives	Property	Active	2016-10-31	0.0%
4	Credit	Credit derivatives	Credit	Active	2016-10-31	0.2%
5	Currency	Currency derivatives	Currency	Active	2016-10-31	14.5%
6	Dissemination	Dissemination derivatives	Dissemination	Active	2016-10-31	-13.2%
7	Total	Total derivatives	Total	Active	2016-10-31	32.4%
Investment certificate						
8	Interest rate	Interest rate certificates	Interest rate	Active	2016-10-31	7.3%
9	Equity	Equity certificates	Equity	Active	2016-10-31	23.6%
10	Property	Property certificates	Property	Active	2016-10-31	0.0%
11	Credit	Credit certificates	Credit	Active	2016-10-31	0.2%
12	Currency	Currency certificates	Currency	Active	2016-10-31	14.5%
13	Dissemination	Dissemination certificates	Dissemination	Active	2016-10-31	-13.2%
14	Total	Total certificates	Total	Active	2016-10-31	32.4%

Solvency II SCR Report

Standard formula SCR %



Risk And Governance

- Portfolio updates
- Economic and strategy updates
- Market risk, capital calculations
- Portfolio stress testing
- Portfolio and strategy review
- Strategic asset allocation
- Review of risk budget



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Practical implications of strategy implementation

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Practical Implication

- Is the existing portfolio liquid?
- How do you manage the exit process from the existing portfolio?
- Do you have to change custodians?
- Do have an agreed ways of working?
- Do you have sufficient internal resource to manage the change?

Questions

Comments

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