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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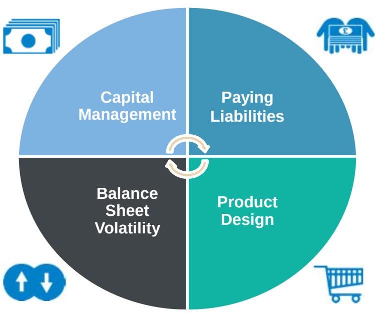
Business Considerations

- Capital charges
- Capital efficiency
- Cost of hedging

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



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

- 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	Fixed Income	Growth Assets
• Money-market strategy • Same day liquidity • **A buffer for liability backing and surplus assets**	• Liability matching • Focused on generating a positive return, but with capital preservation a priority • **To secure the liabilities with a high degree of confidence**	• Captures the higher returns available from growth assets • Risk managed • **To generate capital growth**
LIQUIDITY	LIABILITY	GROWTH

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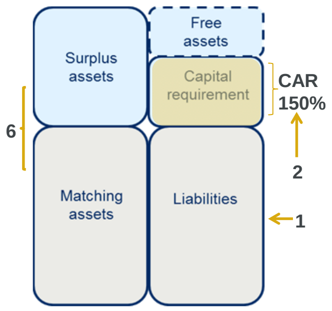
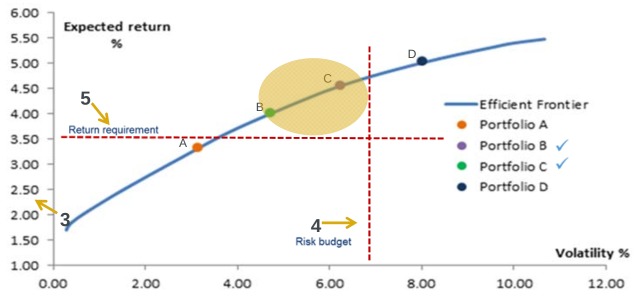
Asset Allocation Exercise





Liability Cashflow Projection → **Set Capital Adequacy Ratio Target** → **Modelling and Stress Testing** → **Risk Tolerance Optimisation** → **Set Pricing/ Guarantee Hurdle Rates** → **Strategic Asset Allocation**

Source: Schroders, for illustration purposes only

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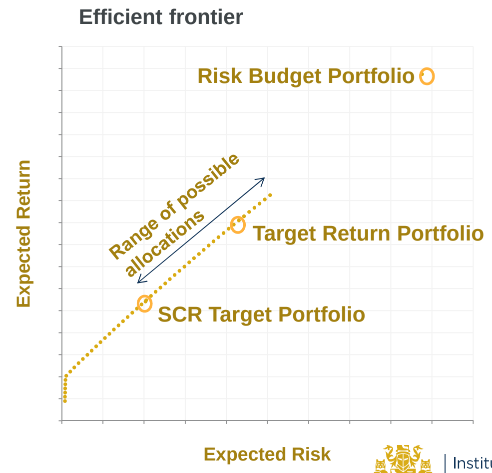
Return vs Risk

- 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



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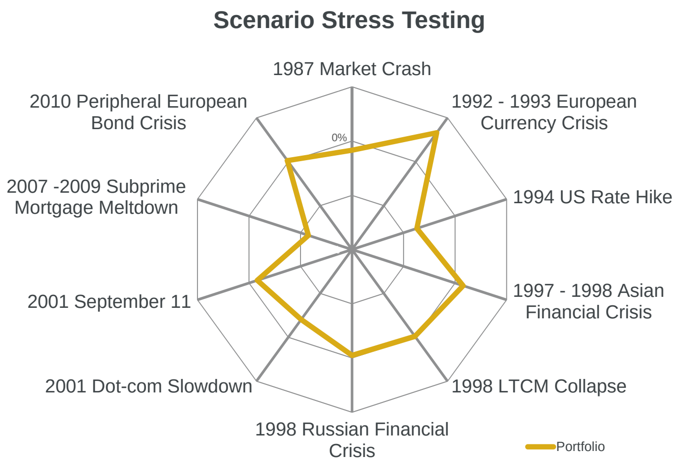
Scenario Stress Testing



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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).

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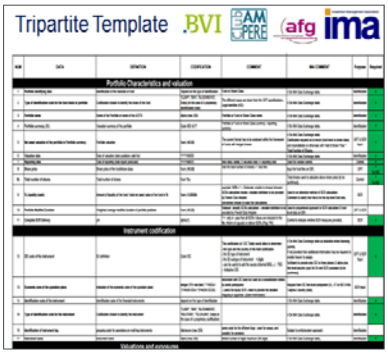
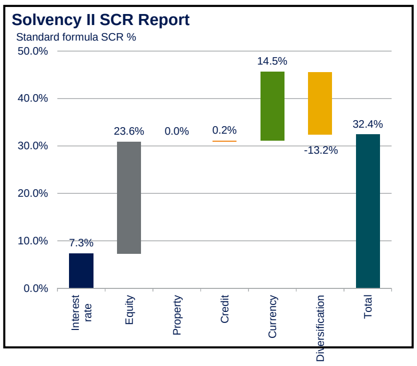
Data and Reporting

Standard Reports
- Valuation
- Performance
- Counterparty Exposure
- Quarterly Investment Report

QRT Reports
- D1
- D2
- D4





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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?

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Questions

Comments

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