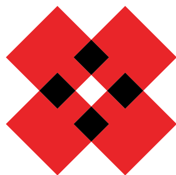

Insurance Asset Management

Summer 2019

Internal models
The benefits of internal models under a Solvency II regime

Lloyd's of London
Update from the world's leading insurance market

Absolute return fixed income
The trends within this investment field and the outlook ahead

The pulse of the industry

How crucial is M&A activity to the health of the insurance market?

US ECONOMIC SLOWDOWN
Effects on insurance companies and the contingency plans in place

ACTIVISM IN INSURANCE
Impacts on insurance and asset management policy

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Internal use of technology systems by insurance firms

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Editorial Comment

In a world in which insurers face growing economic pressures caused by stiff competition on pricing, stock market volatility and persistently low interest rates, it often opens up opportunities for particular governance strategies to take all these points by the scruff of the neck, and offer new ways of navigating such an environment.

This is where mergers and acquisitions (M&A) come into play. According to recent research published by Clyde & Co, global insurance M&A activity has risen by 9 per cent in the past year, as insurers look to reach new customers and markets, and drive down costs by delivering synergies. Our feature (p.24) on this topic looks at what the outlook is going forward around the subject, and whether there are any 'enemies of deal making' out there that could potentially put a stunt on this growth.

This issue also looks at the risk of an expected US economic slowdown (p.28) and the impact that this could have on insurers' balance sheets and investment strategies on a global scale. Alongside this, we also explore internal model structurings under Solvency II (p.40), and the overall health of these compared to standard models.

One area that I have been particularly keen on analysing this issue is the role of activism in insurance (p.34). At a recent Sustainability Summit, which Insurance Asset Management held in London, SIGWATCH managing director, Robert Blood, emphasised how it is now commonplace for European financial institutions to consult with NGOs when drafting or revising policies on environmental and social issues. "This is a big change from just ten years ago, and the reason is the recent financial crisis, which left so many institutions bereft of public sympathy and deserted by political friends," Blood stated. So, at a time when we are increasingly seeing more coverage around climate change and ESG (just recently in London we have seen Extinction Rebellion making their feelings known), the role of activism can play a huge part.

By following the NGO agenda, insurers will be ahead of tomorrow's emerging ESG stresses, I'm sure of that

By following the NGO agenda, insurers will be ahead of tomorrow's emerging ESG stresses, I'm sure of that. Enjoy the issue.

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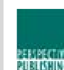

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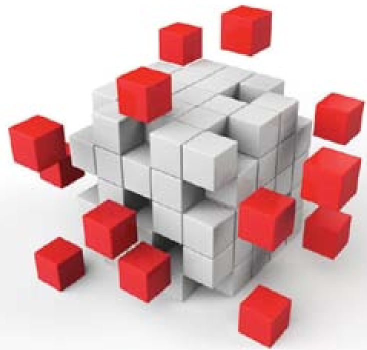

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INSURERS INVEST WITH IMPACT IN MIND

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News focus

SII preventing 50% of insurers from investing in assets related to real economy

Improving measurement of insurers' liabilities among 'key priorities' for 2020 SII review

Written by **Adam Cadle**

Nearly 50% of insurance companies in Europe have reported that Solvency II (SII) is acting as a barrier to investing in assets related to the real economy, according to Insurance Europe.

In its latest Annual Report, Insurance Europe said this figure rose to nearly 60% for companies using the standard formula.

In addition, 70% of companies with long-term business reported that they have made changes to their business. While low interest rates were cited as one of the reasons for this, over two thirds of companies identified SII as one of the causes.

According to the report, of 87 insurers surveyed from 17 European markets, a number of elements have improved however. Ninety-six per cent of companies have seen improvements in risk management and governance due to SII, 76% around asset/liability management, 63% around regulatory harmonisation,
89% in data quality, and 47% in internal modelling.

Insurance Europe also argued in the report, that improving the measurement of insurers' liabilities, better supporting the link between assets and liabilities to correctly reflect the real economic risks faced by insurers, and preserving the effectiveness of internal models are some of the areas that must be the insurance industry's key priorities for the 2020 SII review.

Insurance Europe chair, economics and finance

committee, Gérald Harlin said the industry must also enhance proportionality and its application in practice, improve reporting by focusing on preserving what is actually needed and has proven useful for supervisors and the public, while removing what has proven to be an excessive burden on companies with no benefit for any stakeholder.

He also emphasised the need to level the international regulatory playing field.

“Insurance regulation needs to be strong enough to protect policyholders, but should not hinder insurers’ ability to provide customers with protection and long-term savings and to support economic activity through the products they provide and the investments they make. Risk-based regulation needs to be carefully designed to measure the actual risks,” he wrote.

On the issue of the macroprudential environment, Insurance Europe has argued there is “no justification” for new macro-prudential measures for European insurers, highlighting that the current Solvency II framework is sufficient.

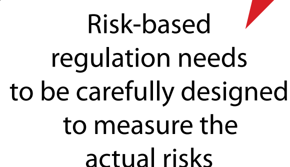
The statement came in response to a question raised by the European Commission (EC) to the European Insurance and Occupational Pensions Authority (EIOPA) on whether the existing provisions of the SII framework allow for an appropriate macro-prudential supervision.

However, Insurance Europe has underlined that the existing SII regulatory framework ensures that any issues leading to concerns in relation to systematic risk can be identified and managed in a timely manner.

The report also touched on sustainable investing under SII. European insurers have committed to invest well over €50bn in sustainable investments between 2018 and 2020, according to Insurance Europe deputy director general Olav Jones.

Jones said “a variety of strategies are employed, including the use of stewardship and shareholder influence, which are quickly growing in importance”.

“Through these strategies, insurers are contributing not just to environmental but also social objectives.”



Addressing the 2020 review of the SII regulatory framework, Jones said “SII should remain risk-based and should not attempt to artificially support green assets or penalise brown ones via artificially adjusted capital requirements, not least because differentiating between green and brown assets is extremely challenging.

“The insurance industry supports prudential rules that capture actual risks based on an asset class’s risk profile.”

News in brief

■ Insurance giant Old Mutual has suspended its CEO due to a ‘material breakdown in trust’. Peter Moyo is to be replaced by chief operating officer Iain Williamson in the meantime.

■ Total premiums collected for 2018 in the Italian life and non-life insurance classes amounted to €145bn, with total funding increasing by 2.9% compared to 2017.

■ Proposals to simplify the Solvency II TMTP calculation have been issued by the PRA in its latest consultation paper (CP). The proposals are aimed at providing additional guidance for firms proposing to use a proportionate approach to the TMTP recalculation methodology and to provide further clarity on the consistency of Solvency I and Solvency II methodologies.

■ UNIQA’s investment income contracted by €39.1m or 28 per cent to €100.6m in Q1 2019, but its investment portfolio increased to €20,102.7m from €19,337.1m.

■ Generali Group has recorded a net profit of €744m in Q1 2019, up 28.1% compared to Q1 2018, and gross written premiums showed 6.6% growth compared to the previous year reaching €18,874m.

■ Luxembourg experienced an increase in all insurance sectors in Q1 2019, boosted by the effects of Brexit. The inflow of life insurance lines rose by 7.19% compared to the first quarter of 2018 and non-life insurance premiums increased by 217.57%, Luxembourg’s CAA said.

PRA approves 24 UK insurers' models for capital requirements

Approval is the highest of any EU country

Written by **Adam Cadle**

The Prudential Regulation Authority (PRA) has approved a total of 24 UK insurers to calculate capital requirements using a model thus far, by some way the highest number by EU country, the regulator's executive director of insurance supervision David Rule has said.

Speaking at the ABI's prudential regulation seminar last month, Rule said this "gives us the advantage of peer comparison".

"We challenge hard where we think model calibrations are weak based on either comparison with other insurers' models or our own view of a risk. At the same time, though, we recognise that every insurer's risk profile is different. Insurers are many and varied. The standard formula cannot be flexible enough to work well for all of them. For this reason, internal models are an important element of the SII framework.

"If an insurer's internal model is well designed, lower risks should lead to a fall in capital requirements," he added.

Considerable model drift occurred in 2016 and 2017, as life insurers saw both standard formula capital and best estimates of liabilities rise considerably more than internal model capital, Rule also said.

Despite this, Rule said the PRA is "not yet ringing the alarm bells".

"First, it is only two years of data. We will need a longer period to draw strong conclusions about trends. Second, some life insurers with internal models have been growing in areas where the standard formula over-states the risks: in particular, illiquid assets within matching adjustment portfolios. Third, life insurers have been expanding unit-linked business and transferring an increasing proportion of longevity risk on new annuities business through reinsurance, both of which would tend to lead to faster growth in the best estimate of liabilities than capital requirements."

Rule said that the two benchmarks against which the PRA compares internal model capital, might not have been fully reliable measures of changing risks.

"Our 'bottom up' analysis of internal model outputs has also not suggested any generalised dilution of standards.

> Internal models are an important element of the Solvency II framework. If an insurer's model is well designed, lower risks should lead to a fall in capital requirements

Nonetheless, the significant reduction in internal model capital compared to the standard formula is not a trend we would expect to continue over time. We will be watching it carefully."

The PRA also announced last month that it is seeking industry input ahead of its 2019 insurance stress test.

In a letter addressed to UK insurance firms, PRA technical head of insurance Stefan Claus said the regulator wants feedback on any aspects of the exercise ahead of its formal announcement to request participation on 1 July 2019. Participating firms will then be requested to complete this exercise by 30 September 2019.

"General insurers will be most familiar with this exercise, as it represents an evolution of the stress testing exercises conducted in 2015 and 2017," he said.

"For life insurers, this exercise captures potential risks that were not fully covered under last year's EIOPA stress test.

"Alongside these market-wide stress tests, we will also be requesting a climate scenario designed to provide additional market impetus in this area, and to inform the Bank's development of a consistent and effective approach to climate-focused scenario analysis."

Non-life insurers now allocating 25% to non-traditional assets

Many insurers have a higher allocation of up to 60%, than the 25% average

Written by Adam Cadle

Non-life insurers are now allocating on average 25% to non-traditional assets, according to latest research conducted by LCP.

The firm said many insurers have a much higher allocation than that, of up to 60%.

A total of 50% of insurers are holding an absolute return or multi-asset allocation, and 50% are holding an allocation to illiquid assets, with direct lending to companies and commercial mortgage loans the most frequently held illiquid assets.

Fifty-five per cent are holding an allocation to equities. Most insurers who invest in equities also use some downside protection, such as put options.

For many insurers improving investment efficiency is a key priority. Many insurers are reducing the number of 'core' investment managers, typically looking to bring down fees and simplify governance. Where new managers are being introduced, typically this is in non-traditional areas where existing managers are not best of breed.

A total of 41% of insurers are currently reviewing their ESG policies.

LCP partner and lead author of the report John Clements commented: "Investing effectively is high on the agenda of non-life insurers, leading to lots of activity across the market. Many investments that may have seemed unfamiliar a few years ago have now entered the mainstream. In this changing environment, insurers want greater visibility of where they stand in relation to the wider market."

> Many investments that may have seemed unfamiliar a few years ago have now entered the mainstream

Moody's warns on risks of moving from IBOR for insurers

Financial, operational, legal and regulatory issues to arise

Written by Adam Cadle

The discontinuation of Interbank Offered Rates (IBORs) in 2021 exposes insurance companies and asset managers to an array of financial, operational, legal, regulatory and technological risks, according to Moody's.

In its latest report discussing the risks, which surveyed roughly 75 banks, insurers and asset managers globally, Moody's said respondents considered the main challenges to be the term adjustment between IBORs and overnight rates, the lack of liquidity for alternative benchmarks and the changes in contractual language for loans, investments, liabilities and hedging instruments.

"Dangers include legal risks that clients and counterparties may not adhere to industry protocols, and operational risks that processes and systems will not be ready and will disrupt business, Moody's VP-Sr credit officer Olivier Panis said.

PRA to further explore risks around illiquid assets for life insurers

Regulator cites 'complexities' and a 'lack of observable market prices' as drawbacks

Written by **Adam Cadle**

The Prudential Regulation Authority (PRA) is to further explore its work on holdings of illiquid assets among life insurers through 2019/20, citing "complexities" and a "lack of observable market prices" as the asset class's drawbacks.

In its *Business Plan 2019/20* published last month, the regulator said since the introduction of Solvency II (SII), UK life insurers have increased their holdings of illiquid assets such as infrastructure, commercial real estate (CRE) and equity release mortgages to back annuity liabilities. However, whilst they can be a good match for long-term annuity liabilities, it said, "they can also be complex, and may lack observable market prices as well as external credit ratings, making it difficult to assess the investment risk firms are taking".

The PRA said it will examine how risks associated with CRE lending are incorporated into internal models, and "will continue to review firms' risk management and governance of illiquid and other assets, including their internal ratings".

"Where we have concerns about particular internal ratings, we may commission an opinion from an External Credit Assessment Institution (ECAI) using powers under section 166 of FSMA."

The regulator stated it will also run a stress test exercise for larger insurers, covering around 85 per cent of the general insurance sector and 95 per cent of the life insurance sector by assets. The aim of the exercise will be to understand sector-wide and individual insurer resilience to a number of scenarios, including natural and man-made catastrophes for general insurers and credit and longevity stresses for life insurers.

Focusing specifically on SII itself, the regulator said it continues to consider the risk margin around this Directive to be "too sensitive" to interest rates and therefore "too large" in the current low rate environment, particularly for long-dates annuity business.

"The current design is leading UK insurers to reinsure the majority of new longevity exposure offshore," it added. "Over the coming year we will keep the implementation of the risk margin under review."

Work will also be conducted around further refining the framework to facilitate the issuance of Insurance Linked Securities (ILS) through ISPVs in the UK with a planned consultation in H1.

> They can also be complex, and may lack observable market prices as well as external credit ratings

On the growing issue of climate change, the PRA said following the setting up of the Climate Financial Risk Forum (CFRF), it has considered responses to its proposed expectations on enhancing banks' and insurers' approaches to managing the financial risks from climate change, and plans to publish final policy in the first half of 2019 and integrate these risks into its supervisory approach.

Photo by: / Shutterstock.com

Johnson hopes for UK insurance firm EU penetration boost

Pushes for deal to allow continuation of insurance services post-Brexit

Written by **Adam Cadle**

UK insurance companies do not have as much penetration in the EU markets as is hoped for, Boris Johnson has said, whilst remaining hopeful of a post-Brexit EU insurance deal.

Speaking at the Biba annual conference in Manchester, Johnson said a deal must be struck to allow the continuation of the free flow of insurance services, post-Brexit, between the UK and the EU.

"Obviously, there would be trade-offs and negotiation – a trade off between greater access and our acceptance of some of their standards," he stated.

"But the advantage of doing a proper free trade deal and not staying in the customs union and regulatory alignment is that stuff that they want to promote on Solvency II, would not necessarily have to be implemented by the UK with all the panoply of regulation and cost involved."

On the state of the UK financial services industry, British trade minister Liam Fox said that Brexit will make it stronger.

Speaking at the Guildhall in London, Fox said "time and time again doom-mongers have predicted the demise of the City, and time and time again they have been proved wrong".

"I am convinced that once the dust settles, the City of London will do what it always does, which is to emerge fitter, stronger and more dynamic than ever."

British financial services minister John Glen said the City of London's traditional strengths were in good health, with new sectors such as fintech growing.

But the "slow and frustrating" process of seeking a deal in Parliament on Britain's departure from the European Union remained a "stubborn" shadow over the sector, Glen said.

I am convinced that once the dust settles, the City of London will do what it always does, which is to emerge fitter, stronger and more dynamic than ever

Interest in Asian fixed income grows among investors

41% of institutional investors plan to increase allocations

Written by **Adam Cadle**

Asian fixed income markets could experience meaningful inflows in the next 12 months from institutional investors around the world looking to take advantage of the higher yields on offer, according to Greenwich Associates.

The firm said institutional investors are being attracted by a maturing Asian fixed income marketplace, also by the need to obtain acutely needed yield.

Forty-one per cent of investors plan to increase their allocations, with 54 per cent maintaining allocations. A quarter of current non-users plan to initiate investment in Asian fixed income in the next year also.

The firm said "opportunities to pick up yield with investments in Asian bonds have become even more attractive since the US Federal Reserve's decision to end its monetary tightening program and put off additional interest-rate hikes".

In addition it said: "Asian markets are becoming more liquid and more deeply integrated into the broader universe of global fixed income. The culmination of this process has been the inclusion of Asian bonds in popular benchmark indices."

> The UN Sustainable Development Goals aim to deliver prosperity for all on a healthy planet

African insurance leaders/UN Environment agree on sustainable development initiatives

Aim is to drive economic, social and environmental sustainability

Written by **Adam Cadle**

African insurance industry leaders and UN Environment have agreed on key collaborative initiatives in the region to drive economic, social and environmental sustainability.

At the 2nd PSI African Market Event in Lagos, hosted by Continental Re, participants agreed that there is a fundamental need to better demonstrate the value proposition of the insurance industry – as risk managers, insurers and investors – in addressing sustainability issues.

Leading Nigerian insurers have agreed to engage with local government authorities in Lagos to explore the development of a 'city sustainable insurance roadmap' - a strategy and action plan to help Lagos become resilient and sustainable. This supports the aims of the Insurance Industry Development Goals for Cities developed by the PSI and ICLEI – Local Governments for Sustainability. The goals serve as a global action framework for the insurance industry to help make cities inclusive, safe, resilient and sustainable in line with UN Sustainable Development Goal 11.

"The UN Sustainable Development Goals aim to deliver prosperity for all on a healthy planet, and are premised on the pledge to leave no one behind," Butch Bacani, who leads the PSI Initiative at UN Environment said.

"This is why the UN's work to achieve sustainable development in Africa is absolutely essential."

The Egyptian insurance industry is to develop a national sustainable insurance roadmap. This roadmap aims to harness the triple role of the Egyptian insurance industry as risk managers, insurers and investors for economic, social and environmental sustainability.

Egyptian insurance industry leaders and financial regulators, UN officials and key stakeholders gathered in Cairo last month at the event *Shaping the sustainable insurance agenda in Egypt*. The event was co-organised by UN Environment's Principles for Sustainable Insurance Initiative (PSI)—the largest collaborative initiative between the UN and the global insurance industry—and by the Egyptian Financial Regulatory Authority and the Insurance Federation of Egypt.

"Sustainability is part of my core mandate as Egypt's insurance regulator. I am delighted that the Insurance Federation of Egypt will be working together with the Egyptian Financial Regulatory Authority and UN Environment's Principles for Sustainable Insurance Initiative (PSI) to deliver a national sustainable insurance roadmap by next year," Egyptian Financial Regulatory Authority chairman Mohammed Omran said.

"We expect this roadmap to enhance the Egyptian insurance industry's resilience, stability and sustainability, as well as contribute to achieving the aims of the UN Sustainable Development Goals and the Paris Agreement on Climate Change."

Allianz aiming for 'climate-neutral' investments by 2050

NN Group announces new coal exclusion policy for underwriting and investments

Written by **Adam Cadle**

German insurer Allianz is aiming for "climate-neutral" investments by 2050, chief executive Oliver Baete recently told shareholders.

"One of the main thrusts of our commitment to society is based on measures to combat ongoing global warming," Allianz boss Baete told the group's annual general meeting in Munich.

"As a leading insurer and investor, we know exactly what the devastating consequences could be when climate policy is exhausted in debates, yet no action follows," Baete added.

"Every citizen, every organisation and every state can make its contribution."

Dutch insurance and asset management company, NN Group, has also stepped in, announcing a new coal exclusion policy for underwriting and investments.

The policy will exclude underwriting and proprietary investment in mining companies that derive more than 30% of their revenue from coal extraction, and of power companies that produce more than 30% of their power production from coal. Nationale Nederlanden also committed to phase out coal from its proprietary investment portfolio by 2030, and only provide new insurance cover to clients that have 5% or lower exposure to coal-related activities by 2030.

The NN Group has €260bn AuM, including €87bn AuM on behalf of clients, and the new policy will affect €540m worth of coal investments. NN will apply the coal power and mining exclusion to its own assets and will encourage its clients to implement the coal mining restriction to the assets NN manages in a discretionary way. The NN Group also published an exclusion list of 36 coal mining companies, citing concerns about climate as the main reason for exclusion.

> Every citizen, every organisation and every state can make its contribution

By committing to gradually reduce the exclusion threshold for power companies from 30% to 0% by 2030, NN is the third insurer, after Allianz and Hannover Re, to commit to fully phase out its own assets. The deadline of 2030 is aligned with climate science goals to keep global warming below 1.5°C.

"NN Group is phasing out coal investments -- a smart move in times when the public's call for climate action is unmistakable; losses from extreme weather events are rising for insurers; and the cost of coal is increasing and costs of wind and solar energy rapidly declining. NN Group is sending a clear message to the financial sector: Investments in coal are outdated and irresponsible. Financial institutions need to walk away from coal and stop investing in burning the planet," Kees Kodde, Campaigner Climate & Energy at Greenpeace Netherlands said.

SCOR has also committed to no longer providing stand-alone coverage to new coal plants.

The insurer has updated its 2017 policy that excluded direct reinsurance for new coal mines and new and existing lignite plants and mines, but not new hard coal plants.

It is not possible to stop climate change without ending the UK's contribution to greenhouse gases in the atmosphere

Working Group publishes framework to better manage exposure to physical climate risks

Ministers also urged by UKSIF to produce Green Finance Strategy

Written by **Adam Cadle**

A cross-industry specialist working group consisting of representatives across the general insurance market has published a framework for practitioners to use to assess the physical risk to insurance liabilities from climate change risk.

The framework has six stages. A physical climate change study would typically aim to inform a business decision or activity. This stage of the framework will decide the time horizon and metrics that need to be considered. The second stage enables the firm to focus on the business areas where the physical risk from climate change could have a material impact on business decisions.

Following on from this, the group said "the firm will need to review existing scientific publications to understand better how climate change could influence the relevant areas identified".

"The likely outcome is a range of projected changes in frequencies or intensities for specific perils," the framework said.

The last stages involve assessing the available catastrophe tools to provide the most suitable analysis, using the tools selected to assess the financial impact from the projected changes to the perils in questions and finally, output from the use of the framework needs to be communicated to decision makers in a manner that can inform the business decision(s) in question. At the same time, ministers are being urged to produce a Green Finance Strategy, that sets out how the government will attract the additional new investment needed to go further and reduce the UK's emissions to net zero by 2050.

The UK Sustainable Investment and Finance Association (UKSIF) said the strategy should also set out measures to improve the way the financial system manages climate-related financial risks, particularly around new low-carbon investment to better protect long-term investors such as pension funds and insurers.

UKSIF has already welcomed the Committee on Climate Change's report recommending the UK sets a target for net zero greenhouse gas emissions by 2050. The Committee on Climate Change has previously estimated that reducing emissions will cost 1-2% of GDP. The Association's head of public policy Ben Nelmes said: "It is not possible to stop climate change without ending the UK's contribution to greenhouse gases in the atmosphere. Setting a net zero target for the UK is clearly the right thing to do. But a net zero target is just the start of the next mountain to climb. Getting there will require radical and unprecedented changes in all parts of the economy."

Netherlands issues first AAA-rated green bond

Hong Kong also launches inaugural green bond

Written by **Adam Cadle**

The Netherlands has recently issued a state bond, becoming the first AAA-rated sovereign to enter the green bond market.

The issuance is expected to give a boost to the country's green capital market and is part of a strategy to lower Netherland's carbon footprint, according to Dutch Finance Minister Wopke Hoekstra.

The strategy includes reducing greenhouse gas emissions by 49 per cent by 2030, which is lower than the EU's 40 per cent.

Dutch NN Investment Partners (NN IP) said in a statement that the issuance plan includes stringent requirements for reporting and transparency and will give the Dutch green bond market an important stimulus.

NN IP said the government's "dark green" bond carries strict criteria and focuses on projects that help adapt to climate change, such as reinforcing flood defences, monitoring and managing water levels and optimising water distribution.

This is different from the other seven sovereign green bond issuers, which are more limited to climate change mitigation in their project financing.

NN IP lead portfolio manager, green bonds, Bram Bos said that institutional investors have often long-dated liabilities which they partially match by buying government bonds.

"Most institutional investors are currently looking for ways to implement their ESG policies and reduce the carbon footprint of their investment portfolios. The Dutch State is the first AAA-rated government to issue green bonds such this gives them the opportunity to greenify their government bond portfolio," he said.

> We think there will be strong interest

"Previous large green bonds issued by France, Belgium and Ireland were heavily oversubscribed. As this is the first AAA-rated green government bond, we think there will be strong interest."

The Dutch state is issuing €4-6bn of the 20-year Climate Bond Initiative (CBI) certified bonds, and plans to increase the outstanding amount to about €10bn in the next few years. This makes the Netherlands the second-largest sovereign issuer of green bonds.

"This shift in governmental policy towards sustainability makes the issue a collaboration between issuer and investors to fight climate change," Bos said.

"This is proof of the transparency and strong governance they are providing for the issuance of their first green bond." According to NN IP, the biggest sovereign green borrowers are France (€16.5bn) and Belgium (€5.7bn).

Hong Kong has also announced the successful issuance of a $1bn inaugural green bond under its Government Green Bond Programme.

The transaction sets a new benchmark for potential issuers in Hong Kong and the region.

People on the move

TAMMY RICHARDSON
Managing Director, UK & Ireland, Insurance Consulting and Technology, WTW

Willis Towers Watson has announced that Tammy Richardson will take on the role of UK and Ireland leader for life and P&C in the firm's insurance consulting and technology business. She most recently served as leader of the UK P&C team within the same business. Richardson has over 25 years of experience in the insurance industry, spanning a range of senior leadership roles.

FRANCESCO MARTORANA
Chief Executive Officer, Generali Insurance Asset Management

Francesco Martorana is the new chief executive officer of Generali Insurance Asset Management, keeping ad interim, his current role as head of investments. He joined the Generali Group in November 2013 as the head of group asset liability management and strategic asset allocation for the general account assets. Prior to Generali he worked at Allianz Group.

ANDY BRIGGS
CEO, UK Insurance, Aviva

Aviva has announced that its CEO of UK insurance has stepped down from his post and as a director of Aviva with immediate effect. Briggs will remain with the group until 23 October 2019 to support an orderly transition. During the interim period, Aviva's current group chief risk officer Angela Darlington will become the CEO of UK insurance. Maurice Tulloch is Aviva's new CEO.

IAIN PEARCE
Chief Financial Officer, MS Amlin

MS Amlin has announced the appointment of Iain Pearce to the role of chief financial officer, subject to regulatory approval. Pearce will join the business forming part of the executive team and will report to CEO Simon Beale. He joins from Old Mutual, where he held a number of senior finance positions over a 15-year tenure. More recently, he held the position of finance director.

CHARLOTTE WILSON
Global Head of Portfolio Solutions, AXA XL

AXA XL has announced the promotion of Charlotte Wilson to global head of portfolio solutions, with responsibility for developing and executing the global strategy for portfolio solutions. Wilson brings 17 years' experience in insurance, having joined Sedgwick Insurance Brokers in 1996 as a graduate trainee. In 2002, she joined Catlin Underwriting Agencies.

RICHARD GLENN
Head of UK Insurance Sales, Invesco

Richard is directly responsible for developing the UK insurance strategy, leading the UK insurance team and executing Invesco's insurance sales plan across the UK. He joins from Nomura International where he was managing director, head of insurance solutions group EMEA. Prior to Nomura, he held investment banking roles at Lehman Brothers and Barclays Capital.

Opinion

On the aim for 'climate-neutral' investments by 2050

"As a leading insurer and investor, we know exactly what the devastating consequences could be when climate policy is exhausted in debates, yet no action follows. Every citizen, every organisation and every state can make its contribution."

Oliver Baete
Allianz chief executive

On African insurance leaders agreeing on key collaborative initiatives

"The UN Sustainable Development Goals aim to deliver prosperity for all on a healthy planet, and are premised on the pledge to leave no one behind. This is why the UN's work to achieve sustainable development in Africa is absolutely essential."

Butch Bacani
UN Environment PSI lead

On the risks of moving from IBOR for insurers

"Dangers include legal risks that clients and counterparties may not adhere to industry protocols, and operational risks that processes and systems will not be ready and will disrupt business"

Olivier Panis
Moody's VP-Sr credit officer

On the need for a post-Brexit EU insurance deal

Photo by: / Shutterstock.com

Boris Johnson
Conservative MP

"A deal must be struck to allow the continuation of the free flow of insurance services post-Brexit between the UK and the EU. Obviously, there would be trade-offs and negotiation – a trade off between greater access and our acceptance of some of their standards. But the advantage of doing a proper free trade deal and not staying in the customs union and regulatory alignment is that stuff that they want to promote on Solvency II, would not not necessarily have to implemented by the UK with all the panoply of regulation and cost involved."

On Brexit's effects on the UK financial services industry

Photo by: / Shutterstock.com

Liam Fox
British trade minister

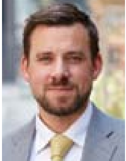
"Time and time again doom-mongers have predicted the demise of the City and time and time again they have been proved wrong. I am convinced that once the dust settles, the City of London will do what it always does, which is to emerge fitter, stronger and more dynamic than ever."

On the US Treasury Department's commitment to continued engagement on ICS

Steve Mnuchin
US Treasury Secretary

"The ICS is an ambitious project that aims to develop global risk-based capital standards for supervisors around the world to use in assessing the financial health of insurance groups. Treasury appreciates the efforts on this project."

INSURERS INVEST WITH IMPACT IN MIND



Insurance investors can now achieve competitive market rate financial returns alongside measurable environmental and social outcomes, says Jonathan Dean, Head of Impact Investing at AXA Investment Managers

WRITTEN BY **JONATHAN DEAN, HEAD OF IMPACT INVESTING, AXA INVESTMENT MANAGERS**

FINANCIAL institutions can no longer ignore the increasingly urgent calls to action over climate change and biodiversity loss.

The landmark *Global Assessment Report* from the Intergovernmental Platform on Biodiversity and Ecosystem Services' (IPBES) recently added to mounting evidence on the rapid deterioration of nature and its dire implications for all humanity.

Meanwhile, global warming as a result of human activity is compounding the destruction of ecosystems, adding drought, ocean acidification and more to the toll.

AXA's ongoing efforts in addressing the challenges of climate change are well-documented. And now the Group has taken a lead in discovering how biodiversity loss and climate change is affecting society and how it can respond as an investor, as well as an insurer.

It recently collaborated with the WWF to produce the report Into the Wild – Integrating Nature into Investment Strategies, which included recommendations for members of the G7 Environment meeting in Metz (5-6 May 2019).

AXA itself has launched a third impact investment fund focusing on these two critical societal challenges. This impact fund will invest up to €200m of AXA capital to finance credible solutions that mitigate climate change and biodiversity loss.

At AXA Investment Managers, Jonathan Dean, who heads up the asset manager's private market impact solutions, believes insurers are uniquely well placed to influence and give momentum to sustainability efforts.

"We are seeing globally organised collective initiatives, substantial commitments to investing in green assets, the establishment of robust climate policies and the exclusion of the most CO2-intensive sources of energy from investments or underwriting - to name a few areas where progress is being made," Dean says.

Impact investing a focus

Impact investing is a natural extension of the trend for responsible investing that already includes the integration of Environmental, Social and Governance (ESG) risk and opportunity factors into insurers' portfolios.

Impact investing goes a step further by financing solutions that directly address environmental or social challenges, thereby creating positive impact for the planet or benefitting the welfare of communities, Dean explains.

In the context of the environment, impact investing could mean funding activities that reduce CO2 emissions or investing in solutions that improve climate change resilience and foster adaption for vulnerable communities.

For example, AXA IM is working with a range of partners and stakeholders to help restore degraded land and prevent deforestation in Peru's Amazonian rain forest, while helping smallholder farmers to develop sustainable agroforestry livelihoods through 'fair trade', organic cacao.

The positive impacts are clear - significant carbon emissions savings, measurably improved biodiversity and improved income generation for communities.

Investors share in the upside generated by the revenues from a premium product and in the tradable carbon credits assigned to the project.

As well as addressing climate change and biodiversity, impact investing can help transform the lives of under-served communities - improving health outcomes or tackling financial inclusion for example.

In one such impact case, AXA IM has invested in the development and distribution of a new, more-affordable

cholera vaccine. Over 17 million doses of the vaccine have been deployed to disaster hit regions - like Somalia, Haiti and Mozambique - and it is estimated that 8.3 million cholera cases and 100,000 deaths have been averted. The impact fund achieved an attractive return on their equity investment on the IPO of the company, and further returns are expected on Loan notes when fully repaid.

"Impact investing is about investing for market rate financial returns alongside intentional and measurable social and environmental outcomes," Dean says. "The market has grown ten-fold in the last five years. When AXA IM entered it was a $50bn market and now it's a $500bn market."[1] This momentum comes from clients demanding tangible returns from their investments beyond financial outcomes, Dean says.

> Impact investing is about investing for market rate financial returns alongside intentional and measurable social and environmental outcomes

Impact outcomes can be pursued across the investment spectrum, from private markets to listed assets. While investing for impact via listed securities can offer relative benefits of scale and liquidity, private market programmes deliver the strongest 'intentionality' around linking capital to impact outcomes, Dean stresses.

AXA IM is ahead of the curve. "We launched our impact programme in 2012 and year-on-year we've built on our expertise, leveraging the rapidly developing market opportunity to meet increasing demand from sophisticated investors, like insurers," Dean says.

The dual-returns objective does require a unique skillset and a highly calibrated investment process, however. "It's a layer of complexity that raises the bar for asset managers," Dean notes.

Tailored solutions

While the impact investing market may be relatively nascent compared with more traditional investment approaches, private market solutions align well with the corporate strategies of insurance companies.

Still, some insurers are sitting on the fence.

"I suggest to insurers that are starting to look at impact investing as part of their asset allocation strategy that they first need to identify their most important corporate values, objectives, and business risks. Plot those criteria back into investable areas in the impact segment and there will be solutions available that can be tailored to those specific priorities," Dean suggests.

"The solutions are out there today that deliver market rate financial returns and target outcomes on environmental and social themes – now it's up to investors to seize the opportunities."

[1] *At end 2018 - GIIN: Sizing the Impact Investing Market*

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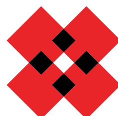

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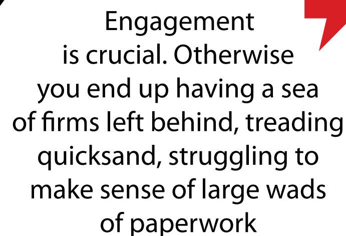
Soapbox

Adding fight

Written by **Adam Cadle**

The fight against climate change goes on. Opinions, beliefs and advice are all now coming to the fore, as global financial institutions look to combat what I believe to be the biggest threat to our planet.

Despite the stats and warnings about the effects climate change could have on the world, none more so than the millions of species on our planet that could be affected, some interesting arguments from both sides of the coin continue to arise. Earlier this year, Californian insurance commissioner Ricardo Lara refused to mandate climate risk disclosures among US insurers, rejecting a petition from more than 60 public interest groups, arguing that climate-related financial disclosures only target a "single element of the much broader challenge of climate risk". Lara stated, however, that he would "rather pursue a much more comprehensive climate strategy that includes incentives for climate-smart investments".



> Engagement is crucial. Otherwise you end up having a sea of firms left behind, treading quicksand, struggling to make sense of large wads of paperwork

Image by: arindambanerjee / Shutterstock.com

I certainly agree with the latter part of this statement but, when we are at such a critical stage in the climate process, I now believe insurers should be mandating climate risk disclosures, not only in the US, but also on a global basis. Greenpeace USA executive director Annie Leonard was also quite condemning of the decision stating that Lara's decision not to pursue common sense is a "gift" to those insurance companies which continue to underwrite coal, oil and gas.

"By refusing to use his authority to hold insurance companies accountable for their continued support of fossil fuels, Commissioner Lara has decided that the profits of a handful of irresponsible insurance companies are more important than the fight against dangerous climate change."

Just recently, a whole host of climate related papers, events and consultations have arisen accentuating just how bad the issue is and what needs to be done. Ministers in the UK are being urged by UKSIF to produce a Green Finance Strategy, setting out how the government will attract the additional new investment needed to go further and reduce the UK's emissions to net zero by 2050. UKSIF said the strategy should also set out measures to improve the way the financial system manages climate-related financial risks, particularly around new low-carbon investment to better protect long-term investors such as pension funds and insurers.

On top of this, we have had the Committee on Climate Change's report recommending the UK sets a target for net zero greenhouse gas emissions by 2050, and the PRA revealing that it will include climate change as part of its mandatory stress testing exercise.

We are at a crucial step in the battle against climate change. We must act now to prevent the situation from worsening or else it will be too late. Industry bodies, experts and organisations need to be singing from the same hymn sheet in order for this to be a success. I therefore strongly believe that Lara's comments around mandatory disclosures do not hold much weight. A system of mandatory disclosures on climate risk among global insurers must be implemented, to add to the fight against climate change.

A CIO's view from Poland

Adam Cadle talks to PZU chief investment officer Robert Kubin about the group's investment strategies in insurance, the effects of Brexit and the overall outlook for the firm

WRITTEN BY **ADAM CADLE**

The PZU Group is the largest financial group in Central and Eastern Europe with nearly 300 billion PLN of assets under management, and enjoys the trust of more than 22 million clients in five countries. Headquartered in Warsaw, it is also Poland's oldest insurance company. The company's origin dates back to 1803. In the years 1927-1952 the company operated under the name Powszechny Zakład Ubezpieczeń Wzajemnych and between 1952-1990 it was knows as Państwowy Zakład Ubezpieczeń (State Insurance Company) as it was officially given a monopoly by the state. PZU was first quoted on the Warsaw Stock Exchange in May 2010.

The 'New PZU' is much more than insurance. Its companies are active not only in life, non-life and health insurance but also in investment, pension, health care and banking products.

At the same time, to lend credibility to our profile as a company that anticipates the future, we are dedicating substantial attention to artificial intelligence and working on the largest client database in Poland, which the PZU Group has at its disposal. Gradually, it will move the its operating model from that of an insurer (pricing and transferring risk) to the model of a service company specializing in harnessing data (risk management consulting and services) as well as caring for the future of clients, retail and business, alike.

The values it will retain primarily involve stability: as defined by always keeping its Solvency II ratio above 200%; ROE specified as being above 22%; the promise of sharing the profits that are not needed to finance our rapid growth.

Q Robert, what is your overall investment portfolio structure and what are your main asset allocations in?

PZU is in a very specific situation as we are a large insurance company which predominantly operates in non-hard currency markets. As such, we are fully utilising the investment options available within Poland but are also investing a portion of the balances sheet within global markets to diversify on one hand and to get an exposure to assets not available in the local markets on the other. Specifically, we invest into wide variety of asset classes, such as government and corporate bonds – both local currency and hard currency, investment grade and below investment grade, EM and DM, private assets (bonds and loans), real estate, equity and PE and VC.

Q How have allocations changed, say, over the last five years?

The company works constantly on optimising the investment strategy within the risk management framework given by the enterprise with the aim to provide stable and predictable investment income. We made a lot of efforts in terms of seeking new and new asset classes which significantly differentiates us to our competitors whose investment strategy isn't that advanced. This is an ongoing process which will be never finished. In the past years, the investment strategy significantly evolved from investing almost entirely into local government bonds first to utilising all the investable options available within Poland and then gradually shifting to investing into well diversified global portfolios. The strategy also evolved from a one purely internally managed to a one where we cooperate with third party asset managers that help us invest into asset classes where we don't have a detailed in house expertise and it doesn't make sense to build it internally given geographical, economic and other constrains.

Q How is PZU adapting to Brexit, both in terms of geography and the investment portfolio?

Given the fact that we don't operate in the UK, Brexit is one of the risks that we are looking at and analysing but not the biggest one. We are assessing our exposure to assets that might be affected by Brexit and are also working hard to ensure that the operational risk potentially associated with Brexit is understood and managed.

Q What have the effects of Solvency II been on your investment portfolio?

We fully adopted the Solvency II framework within the DNA of the company and capital management is an integral part of our daily decision making process. Ensuring that the company's capital doesn't fall below a predefined level under a significant stress scenario is one of the very important anchors we take into consideration during our investment management process. We however don't want to stop there and are trying to think beyond Solvency II and are trying to come up with an Investment

> **The company works constantly on optimising the investment strategy within the risk management framework given by the enterprise with the aim to provide stable and predictable income**

management framework that not only relies on Solvency II but also takes into consideration our unique position on the market, the sensitivity of the shareholders to the acceptance of various risks, the way that various risks interact together and the strategic targets that the management of the company is aiming to accomplish.

Q What are the main aims over the coming years for PZU and yourself as CIO?

The main aim is to continuously build upon the work already done within the company. We are aiming at delivering our financial and other targets as well as to ensure the stability and predictability of the financial results and the dividend capacity. We are further seeking for new asset classes that might comply with our investment policy and we try to improve the management of the asset classes that we already invest into. short duration and high quality credits.

The pulse of the industry

Despite macroeconomic and geopolitical distress signals flashing up on dashboards across the insurance sector, the road still looks clear for high levels of M&A activity

WRITTEN BY **MAREK HANDZEL, A FREELANCE JOURNALIST**

Whether it be Bain Capital's unsolicited purchase of esure, the controversial merger between Marsh and JLT, or AXA's audacious acquisition of XL, M&A megadeals have been the talk of every town. Last year, their looming presence led to a sense that consolidation within the insurance sector was reaching new heights.

This instinct was confirmed in February by Clyde & Co's latest insurance growth report. Navigating a course between uncertainty and opportunity reported that 382 mergers and acquisitions were completed across the globe in 2018 — a nine per cent jump on 2017's total of 350 deals.

The law firm's report once again placed the Americas as the most active region for M&A, with 189 deals in 2018. Europe was home to 122 completed deals, up from 118 in 2017, while Asia Pacific experienced a relatively large gain in deal activity out of the three main regions, with 59 deals, up from 42 in 2017, with M&A accelerating through the year.

The state of play in both Europe and Asia Pacific can be explained by some clear external factors. As Tan Pawar, senior vice president of M&A at broker Paragon points out, the weakening of UK sterling following the UK's decision to leave the EU has made investment into the country more attractive. At the same time, UK-based players have ramped up M&A activity in mainland Europe.

"This has involved mid-market smaller players looking to invest in opportunities on the continent so that they can maintain their ability to trade and gain access to Europe," Pawar states. "There was a concern about passporting that will remain until we know where we stand on the Brexit issue. A lot of people know that this would be a good time to invest in partners on the continent, either organically, or by buying a competitor."

In Asia meanwhile, the twin engines of healthy GDP growth and middle class expansion have turbo charged the need for insurance. Michael Hatchwell, a partner at law firm Child & Child and director of the Globalaw Foundation, says that outbound and inbound M&A capital in Asia Pacific has therefore become increasingly significant. "With the success of the Asian region generally, there are increasing numbers of companies that are reaching out to become more global. And that's relatively

> In an environment where pressure is intense and investment returns are hard to generate, it is easy to see the appeal of M&A

new in the insurance world."

Pawar concurs, using Marsh's amalgamation with JLT as evidence of Asia's increasing influence on strategic thinking. "Taken in isolation, everyone acknowledges Marsh as the bigger partner in that tie-up, but Marsh has been looking to get a stranglehold on the Asian market — and historically JLT have done particularly well there."

PE and fuelling M&A

In a broader global context, Clyde & Co's corporate insurance group global head Andrew Holderness says that M&A transaction activity has been given impetus by regulation, stiff competition on pricing, stock market volatility and persistently low interest rates.

"A merger or acquisition remains a perennially attractive strategy for any insurance business with growth ambitions. It offers the promise of delivering cost synergies as well as access to new markets and customers that can help to boost revenues," Holderness explains.

"In an environment where pricing pressure is intense and investment returns are hard to generate, it is easy to see the appeal of M&A."

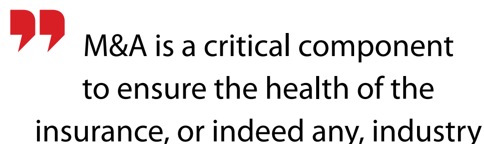
Added to the mix is the rise of private equity capital, which now has its sights firmly set on the insurance world.

According to Willis Towers Watson, you only need to go back five or six years to find that private equity investors used to be fringe players in the market. Speaking to the consultant's own in-house publication, Emphasis, Fergal O'Shea, EMEA life insurance M&A leader, says that private equity houses are now prominent in a large number of transactions, "partly because of the current chase for yield, making insurance stocks relatively more attractive". His colleague, Jack Gibson, a senior strategy consultant in the US, points to a growing number of "broad, diverse array of investors" who have the will and capability to take on complexity, something that a traditional insurance company or bank might shy away from at present. "This has manifested itself, in particular, in more deals involving a consortia of financial investors — deals that would have been very difficult to complete in the past," he says.

Upgrading tech specs

InsurTech has also injected some speed into M&A activity. According to Deloitte, insurance companies looking for cheaper ways to meet customer demands for quicker and more convenient ways to buy and manage policies has led to investment specific InsurTech capabilities. In its 2019 Insurance M&A Outlook, the consultancy explains that these capabilities now cover the entire gambit of an insurer's business, including "product development, sales and distribution, policyholder services, underwriting, and claims management".

"There's a growing understanding that the industry is ripe for disruption and, to survive and thrive, insurers should leverage InsurTechs' entrepreneurial thought processes, nimbleness, and flexibility to improve their existing operations," write the report's authors. "But how? It can be difficult and costly for large companies to germinate, cultivate, and incorporate truly disruptive ideas from within.



One faster, less expensive option is to acquire that knowledge."

Clear roads ahead

In its report, Deloitte also predicts that insurance companies of all types will invest and partner with more InsurTech operators, while also eyeing up MGAs and brokers in an attempt to secure profitable and growing routes to market that "may even replace certain incumbent teams and processes."

Within Europe's main markets, geopolitical events and regulation will also power further M&A deals, in Deloitte's view.

A new French ruling, Plan d'Action pour la Croissance et la Transformation des Entreprises (the action plan for business growth and transformation), is expected to boost retirement savings for insurers and asset managers, while IFRS 17 implementation could heap significant costs into French-based insurers, resulting in further consolidation at the smaller end of the sector. In Germany, many life insurers are bracing themselves for the culmination of a gradual phase-out of 15-year transitional relief in the valuation of insurance reserves under IFRS. This, says Deloitte, may well increase pressure on solvency margins.

Brexit's ongoing uncertainty is also likely to maintain UK companies' push to secure access to European markets as well as encourage opportunistic deals in the UK.

Potholes rather than sinkholes

However, in defiance of such bullish M&A forecasts, 2019 has experienced a slow start in announced and completed deals both in Europe and the US. This is partly down to the natural cycle in the market, says Clyde & Co's Holderness, but can also be attributed to heightened investor caution due to economic and political developments, such as tensions between China and the US and disappointing GDP numbers across Europe.

Should a prolonged economic slowdown become reality, then Paragon's Pawar believes that dealmaking will also have to take its foot off the pedal. "What we saw in the last cycle, especially in the last downturn, is insurance rates becoming far more competitive to try and boost purchasing in a hardening economy," he says. "If there is any global economic slowdown, that would have some impact on M&A activity in the sector."

"The big question now is the extent to which the market will harden," Holderness says. "Market reports show that we are seeing measured price increases in certain lines of business. These are unlikely — in the near-term at least — to offset the years of difficult trading conditions we have experienced. We would expect M&A to remain a feature of the insurance industry for some time to come, with a pick-up in activity expected in the second half of the year."

His optimism is influenced by two key concerns for the insurance sector — data and business agility.

"[This] will increasingly be the prime factor in deepening customer insights and establishing a position of dominance in the market," he says. "M&A offers acquirers access to a vastly expanded pool of customer data."

"M&A is a critical component to ensure the health of the insurance, or indeed any, industry. Markets don't stand still. They are constantly developing and evolving, so companies need to change and adapt as well. The ability to acquire or dispose of assets is a critical channel to ensure that businesses can thrive."

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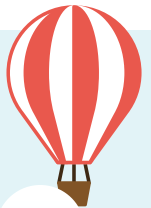

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A deadly concoction?

Economic slowdown in the US, and global market volatility are now among the top concerns for investment CIOs and CFOs in 2019. David Adams analyses why this is the case, the impact on insurance companies and the contingency plans in place to deal with this

WRITTEN BY **DAVID ADAMS, A FREELANCE JOURNALIST**

In hazardous and unpredictable financial conditions, which of the many risks facing investors should be of most concern to them? Sluggish growth in many economies and the possibility – or probability – that the credit cycle is coming to an end were sources of anxiety throughout 2018 and the first half of 2019, but two other prominent sources of risk are highlighted in Cautiously Optimistic, the most recent edition of the Goldman Sachs Asset Management (GSAM) Insurance Asset Management Survey, published in April. They are: the risk of a recession in the US in 2020; and the broader consequences of volatility in the credit and equity markets. So should these two risks be the most important sources of concern to CIOs and CFOs in the insurance industry?

Threats

GSAM surveyed 307 CIOs, CFOs and senior investment professionals working across the globe, including representatives of insurance companies with investments worth over $13 trillion. More than eight out of ten (82 per cent) predicted a US recession in 2020 or 2021. More than one in three (35 per cent) ranked the possibility of a US slowdown or recession as the greatest macroeconomic risk to their investment portfolio and two-thirds (68 per cent) listed it as one of the top three risks. Twenty per cent put credit and equity market volatility at the top of the list, with more than half (52 per cent) placing that risk in the top three.

A huge majority of respondents to the survey (85 per cent) believe we have reached the late stage of the credit cycle, compared to 34 per cent who thought this was the case when questioned for the 2018 survey. Nearly one in four (38 per cent) say credit quality deterioration was the investment risk causing them the greatest concern. But they offer a nuanced forecast of what this might mean for credit spreads during 2019: 44 per cent chose the 'modestly tighten to modestly widen' category, down from 54 per cent in 2018; while 52 per cent said spreads would moderately widen, up from 39 per cent in 2018.

"So we would be talking about more of a gradual soft landing at the end of the cycle, not a radical move in defaults or spreads," GSAM managing director in the investment management division Etienne Comon deduces. If the survey respondents are right about this and in their view of the US economy's prospects, the cycle will turn just as a recession begins there.

But in May, Oxford Economics published an economic forecast suggesting the US was not, in fact, heading for a recession, although annual GDP growth would slow, from 2.9 per cent in 2018 to 2.6 per cent in 2019, 1.7 per cent in 2020 and then 1.8 per cent in 2021. It suggested slower income growth, lacklustre global activity and increased trade tensions would remain downside risks. The forecast also stated that "rapidly growing corporate debt of lower quality should be monitored closely", noting the potential for a highly leveraged corporate sector to spark market sell-offs and increased volatility.

Zurich Insurance Group chief market strategist and head of macroeconomics Guy Miller says he and his colleagues expect a "mild" US recession in 2020, created in part by economic expansion creating more job vacancies than can be filled. "Employment is at a 50 year high, but when there are more job openings than there are unemployed workers you can't keep growing at the same pace," he says. The effects of the Trump administration's fiscal stimulus are also fading.

The US Federal Reserve has surprised markets in recent months by turning away from expected interest rate increases. "That has clearly shaped asset volatility," Miller states. "Because the markets believe the Fed will not

be raising rates that has allowed other central banks to loosen [monetary] policy. That has changed the investment landscape, encouraging investors to move into riskier assets."

A US recession might also be a consequence in part of ongoing hostility over trade tariffs between the US and China. "There's a real risk this will become seriously detrimental to the economic prospects of the two biggest economies in the world," Oxford Economics head of global macro strategy Gaurav Saroliya says. "That's not going to be good news for any investors."

"It's not only about China and the US," Insight Investment head of insurance Heneg Parthenay adds. "The tariff war could drive volatility in foreign exchange around the world."

> It's not only about China and the US. The tariff war could drive volatility in foreign exchange around the world

PwC UK partner, head of strategy and chief operating officer Shazia Azim sees a combination of factors creating difficulties and concerns for asset managers working for insurers. "You have a low rate environment in which returns are very difficult to make, and central banks saying they are not going to raise rates," she says. "Add to that an economic slowdown in the US, protectionism and trade wars and you have a pretty unhealthy soup. Not just for equities and fixed income, but alternative assets, real estate and hedge funds – all are exposed."

But Miller notes that so far in 2019 there has been less volatility in the markets than some had expected. "Market volatility is very subdued right now – but unsustainably so," he says. "We've been in a situation where equities are rallying, credit is rallying, government bonds are rallying and volatility is coming down. This is unlikely to continue."

Insurers' portfolios should be in a reasonably strong position to withstand some volatility. But even they would be adversely affected by more widespread volatility in global markets that could be created by another geopolitical factor: rising tensions among the oil producing countries of the Middle East; and in particular between Iran and Saudi Arabia, with the US and other outside actors also taking a close interest.

"Conflict leading to a spike in oil prices would be a powerful push towards a global recession, because many economies are in a fragile state," Saroliya says. He also points to other geopolitical issues that could have broader economic consequences, including the ongoing nuclear crisis on the Korean peninsula and apparently endless

political turmoil related to Brexit.

Contingency planning

What strategies should insurers be pursuing to minimise the impact of these risks? The GSAM survey suggests insurers are continuing to de-risk in terms of equities, while seeking to increase use of less liquid asset classes including private equity, infrastructure debt and middle market loans.

AXA Investment Management Managers head of buy and maintain Lionel Pernias suggests insurers seek to future-proof portfolios against downgrades. "We buy bonds, but intend to hold them to maturity, so invest only in companies robust enough to go through the market cycle," he says. He also reminds insurers to pay careful attention to over-leveraged corporates, particularly triple B-rated companies.

Comon says insurers must invest in credit that can offer "the greatest possible resilience at this stage of the cycle". This could mean investing in private credit, negotiating covenants that provide legal protection.

PwC UK associate director Matteo Ricciarelli notes that insurers may seek to make their portfolio more resilient to credit events by underweighting a market where they feel credit events are more likely to occur; and that they are seeking to diversify by looking at other assets including direct real estate lending, infrastructure, and direct equity.

> The cycle is getting ever later. July will mark the longest US expansion in history. We don't think it's the end of the cycle yet

For Zurich, Miller restates the importance of "a very strong discipline about matching our assets to our liabilities", but he also emphasises again the need to prepare for the end of the credit cycle.

"We're not taking any big deviations outside those liabilities," he says. "We manage through and across cycles to get our risk premia. But the cycle is getting ever later. July will mark the longest US expansion in history. We don't think it's the end of the cycle yet, but we're getting close."

So, which risks should be of greatest concern to insurers? Well, all of them: volatility, a US recession and the end of the cycle are all coming, at some point. Hopefully none of them will spell disaster for insurers, but investors would be wise to prepare for several different versions of the worst.

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Postcard from America

Oliver Wade talks to American Property Casualty Insurance Association (APCIA) vice president and chief international counsel Steve Simchak about the industry body and the US insurance market

WRITTEN BY **OLIVER WADE**

Q What is the APCIA and what influence does it have over the American insurance market?

Representing nearly 60 percent of the US property casualty insurance and reinsurance marketplace, the APCIA promotes and protects the viability of private competition for the benefit of consumers and insurers. APCIA represents the broadest cross-section of home, auto, and business insurers of any national trade association. APCIA members represent all sizes, structures, and regions, which protect families, communities, and businesses in the US and across the globe. APCIA member groups serve customers across the United States and in over 170 countries and territories around the world.

Q How would you describe the current state of the property and casualty, life and reinsurance markets in America?

The state of the US insurance industry is strong, as US economic expansion has continued to grow. S&P recently noted that insurers' financial strength is very good, and balance sheet strength continues to be ample for protection from any potential challenges. We are seeing demand grow for emerging products like cyber insurance; and the utilisation of InsurTech is allowing the industry to be more efficient, improve policyholder experiences, and reach under-insured populations.

Q Solvency II, a European directive, places a strong emphasis on adequate capital requirements for European insurers. What capital requirement standards are being enforced in the US?

In the US, insurance is regulated at the state level rather than at the national level. The state insurance commissioners employ a risk-based capital (RBC) requirement that was developed by their national coordinating body, the National Association of Insurance Commissioners (NAIC). RBC is a method of measuring the minimum amount of capital appropriate for an insurer to support its overall business operations in consideration of its size and risk profile. RBC is central to a set of tools that US commissioners use to regulate capital adequacy in the US

Currently, we are witnessing an interesting evolution of capital supervision in the US. The NAIC and the Federal Reserve are independently developing group capital assessment methods for US insurance groups, based upon aggregation of existing legal entity capital and capital requirements.

Q What risk strategies have American insurance firms adopted

and how are they being implemented?

The stability of the US insurance sector over the years is a testament to the strong outcomes of insurers' ability to measure and manage their risks effectively and our collaborative relationship with our supervisory authorities.

> **The stability of the US insurance sector over the years is a testament to the strong outcomes of insurers' ability to measure and manage their risks effectively**

Q European insurers have received increasing pressure from non-governmental organisations and bodies in relation to climate change and sustainable investing, with many insurers having now signed the Paris Agreement, including American insurers. If any, what additional initiatives and/or trends are being seen in the American market to combat climate change?

Insurers are in the business of resilience both through the products we offer and the investments we make. US insurers and reinsurers are focused on better assessing, pricing, and underwriting for all risks (including natural catastrophes), investing according to regulatory and prudential rules and responding to the needs of policyholders and investors. In addition, insurers are leaders in researching and providing resources to their customers and the general public on the impacts of natural catastrophes and how to prevent and reduce losses.

Insurers want to support resilience wherever it makes sense, but frequently we find that governments in foreign countries that are most exposed to natural catastrophes prevent US insurers from helping by erecting market access barriers. We have a lot to offer to resilience efforts through access to global risk diversification, risk mitigation practices, highly-advanced risk modeling, insurance products that fund recovery, and investments in sustainable infrastructure. The bottom line is that US insurers and reinsurers have their hands tied when foreign governments prevent them from helping with resilience in their markets.

Spreading the message

Activism is rife on climate change and a range of other social issues, with a growing impact on policy in insurance asset management, Graham Buck reports

WRITTEN BY **GRAHAM BUCK, A FREELANCE JOURNALIST**

Gentle persuasion can prove effective, but sometimes a message has to be delivered more forcefully. That's the policy most publicly pursued by the activists of Extinction Rebellion, who brought widespread disruption to central London in April, but it's also increasingly being adopted by many major institutional investors. Many are deciding that when companies they invest in are slow to improve their performance measured by environmental, social and corporate governance (ESG) criteria, they will find an alternative home for their funds.

Ratings agency Standard & Poor's has noted the trend and is launching an ESG version of its S&P 500 index in the US and rolling out regional versions globally in response to increasing investor scrutiny of a company's social conscience.

To take one example, Legal & General Investment Management (LGIM) last year began naming the companies that it regards as "leaders" and "laggards" in responding to climate change and phasing out activities that adversely affect the environment. Eight companies appeared on its blacklist for their failure to engage with LGIM on the issue of climate change: China Construction Bank, Dominion Energy, Japan Post Holdings, Loblaw Companies, Occidental Petroleum, Rosneft Oil, Subaru and Sysco Corporation. Warning of the prospect of a "climate catastrophe", in April LGIM reported that it was adopting a tougher stance on a variety of ESG issues. These include greater gender diversity in boardrooms; in 2018 LGIM opposed the election of the chairman of more than 100 companies where female representation on the board of directors is still less than 25%, against 37 similar revolts the previous year.

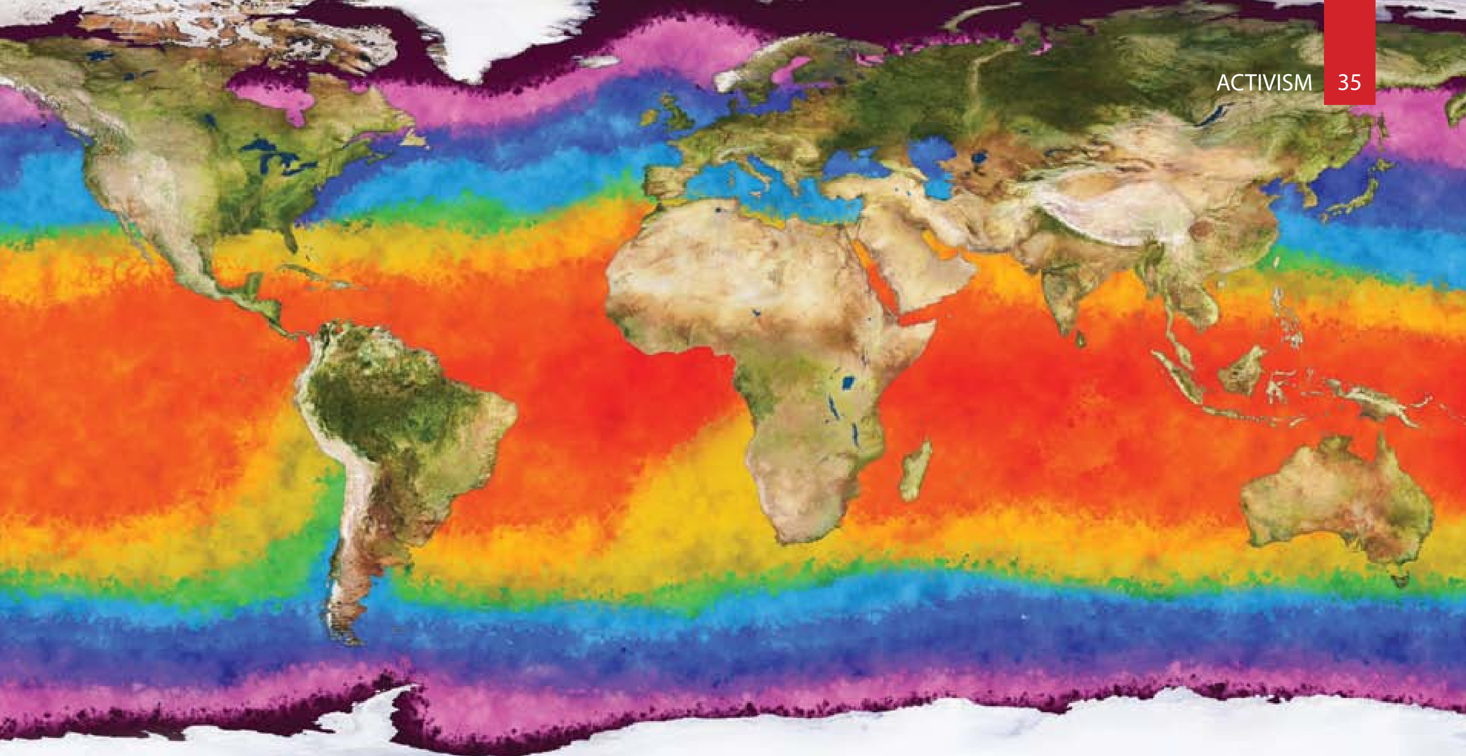
Robert Blood, founder and managing director of reputation management firm Sigwatch says that institutional investors in Europe, North America and Australia have grown accustomed to non-government organisation (NGO) activism that directs them where to – or rather where not to – invest their money. However, even investors in less "adversarial" economic regions such as Southeast Asia are now responding to these professional advocacy groups.

Research and consulting firm Cerulli Associates' recently published report, European Insurance Industry 2019: Uncovering Outsourcing Opportunities, notes a "significant shift" toward responsible investing (RI) in Europe's insurance sector and suggests that insurers are increasingly seeking guidance from asset managers on how to integrate ESG factors into their investment processes.

Around half of the insurers the firm surveyed already exclude industries that do not meet their ESG standards, including tobacco and coal, and apply ESG scoring to other sectors. Other insurers are moving to ESG-focused benchmarks for all the major asset classes.

"As insurers expand their use of RI approaches, they increasingly want to measure the environmental and social impact of their portfolios," says Justina Deveikyte, associate director in Cerulli's European institutional research team and the report's lead author. "Asset managers need to develop innovative ways to measure and report the impact of investments.

"Insurers across Europe are increasingly trying to adopt a holistic approach to RI. Managers need to be ready to discuss ESG integration with insurers over the coming 12 to 24 months. They should be prepared to give clear advice on what insurers



should be considering buying and excluding and what the important factors are when it comes to ESG investing."

A coordinated campaign

Helena Viñes Fiestas, head of stewardship and policy at BNP Paribas Asset Management, is also member of the European Commission's technical expert group on sustainable finance.

She reports that the climate change lobby has been joined by the Church of England Pensions Board which, together with the Swedish national pension fund AP7, leads a coalition of pension fund investors who are challenging multinational companies on climate change.

The group, which has been joined by LGIM and asset manager Robeco, collectively has around $2 trillion of assets under management. Last autumn members targeted 55 companies, which they felt were lagging in their efforts on the environment. Car producers Volvo and BMW, energy utilities E.On and Centrica and consumer products giant Nestlé were among those asked to review the "insidious" lobbying practices employed by their trade associations and lobbying companies, to ensure that they tally with the company's own stated support for the Paris climate agreement. The letter to the chair of each company comments: "Companies may face backlash from their consumers, investors of other stakeholders if they, or the organisations that they support, are seen to be delaying or blocking effective climate policy."

Viñes Fiestas adds that Brussels has also been "extraordinarily busy" in the past 18 months, bringing sustainable finance very much to the forefront.

The European Commission has published draft rules on how to incorporate ESG preferences into investment. Last July, the EC set up the Technical Expert Group on Sustainable Finance (TEG), with the following remit: an EU classification system – aka taxonomy – to determine whether an economic activity is environmentally sustainable; an EU 'green bond' standard; benchmarks for low-carbon investment strategies; and guidance to improve corporate disclosure of climate-related information.

Recently the group launched a consultation period following its preliminary recommendations on the guidelines for EU 'green bond'. Issues. However, there has been debate around the degree of power that should be delegated to the Commission in driving the initiative. "There is a range of views, or 'different shades of green' on what the taxonomy should look like and how it should work," says Fiestas.

Green bond pioneers include the European Investment Bank, which last September issued its first sustainability awareness bond (SAB), marking the EIB's first venture into the capital market on sustainable objects beyond mitigating the effects of climate change. The debut met with a strong response from investors, with demand exceeding €1 billion.

ESG agendas

At AXA Investment Managers, its head of ESG research and active ownership, Yo Takatsuki, says the group has a "comprehensive and systematic"

programme of engagement on behalf of clients, which covers its equity and corporate bond holdings.

"Engagement is a core component of protecting and enhancing the value of investments for insurance asset managers as we are long-term investors in the true sense," he says. "For example, a significant proportion of our fixed income exposure is on a buy-and-maintain basis.

"This means we hold until maturity in most cases, so for medium-to-longer dated bonds ESG risks have the time to materialise and affect the value of our investments. Engagement is a key tool with which we seek to manage and monitor our investments in an effective fashion.

"We are constantly strengthening our approach to engagement – we cannot sit still. This partly reflects the ever-evolving expectations from stakeholders on our approach to managing ESG issues, which includes clients, regulators and NGOs."

At PIMCO, its head of EM sovereign credit, Lupin Rahman, says the group has incorporated "material ESG factors" in its investment policies for many years. "Our process emphasises rigorous analysis of broad secular trends, which are at the core of both global ESG trends and long-term asset returns. We evaluate ESG risk factors from both the top-down (i.e. macro) and bottom-up (i.e. security specific), and use a three-step approach – exclude, evaluate, engage – to construct ESG portfolios.

> Companies may face backlash from their consumers, investors of other stakeholders if they, or the organisations that they support, are seen to be delaying or blocking effective climate policy

"We believe that by analysing ESG risk factors alongside traditional financial risk factors, we will have a more complete picture of the risk and return opportunities that will ultimately help deliver better outcomes for our clients.

Invesco is similarly committed to influencing corporate behaviour and regularly engages with investor-led organisations and initiatives, says Elizabeth Gillam, its head of EU government relations and public policy at Invesco.

"The insurance sector in this prospective takes a double role of being itself an activist in collaborative engagement as asset owner, and at the same time a target for some of the controversial assets that they may own as shareholders," she says.

Gillam cites the EU's sustainable finance agenda as a prime example of NGOs actively seeking to influence the policy agenda and how the finance industry operates. "A number of NGOs were key players in the high level expert group on sustainable finance set up by the EC and continue to be actively involved in the legislative work that has come out of this group.

"In particular, the NGO community have partnered with European politicians to go beyond the "financial materiality standard" traditionally used by the financial sector towards requiring the industry to take into consideration the impact on the environment and society more broadly."

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DELVING DEEP

J.P Morgan Asset Management's panel of experts analyse and explore the latest trends within the global insurance sector

WRITTEN BY **ADAM CADLE**

Global insurance trends
J.P Morgan Asset Management's (JPMAM) latest insurance roundtable kicked off with an outline of current global insurance trends, and how the asset manager is working within this to attract business. The firm's international head of insurance solutions Mark Oldcorn spoke of an increase in M&A activity, as insurance companies look to consolidate. This in turn provides opportunities for JPMAM, working with both firms in the M&A deal, on how to better allocate capital across liabilities and assets, how to more efficiently manage the asset side of the balance sheet, and work with buyers on assessing targets.

Alongside this, Oldcorn emphasised that asset managers are having to deal with low interest rates and credit returns, so are stepping up their search for yield by looking for more remunerative fixed income and alternative investment strategies, under the whole diversification umbrella. "The fundamental analysis of fixed income and equity investments, along with analytical capabilities are the skills needed to benefit from this environment," he stated.

Solvency II and portfolio management

Global head of insurance strategy and analytics Gareth Haslip spoke of the trends in the UK and European insurance space over the last year or so, particularly around Solvency II. Haslip said the situation is "business as usual" and "systems are in place", but the industry is seeing "quite a bit of volatility" in the Solvency II ratio – the ratio of own funds to required capital. The volatility for some insurers is being driven by the change in their capital requirements.

"As their strategy changes, looking to write new business and increase underwriting capacity, that's obviously capital-intensive," he underlined. "For others, it's the own funds part where there has perhaps been reserve deteriorations, or there have been movements in the value of assets especially with equity prices falling at the end of 2018. All of these things can cause volatility in the Solvency II ratio. Over 2017, we saw 10% of companies across Europe have an absolute decrease in their Solvency II ratio of over 20%."

JPMAM is helping in two ways, one by aiding with investment strategies that result in a less volatile surplus, through thinking about interactions between assets and liabilities, through the use of the volatility adjuster and matching adjustment, and secondly thinking about how to make strategies more capital efficient by trying to reduce the capital consumption of the investment portfolio.

"That comes through adding diversification, but also being smarter about the way you pick securities. So, we do a lot of work now in security selection under Solvency II to optimise core fixed income or extended fixed income strategies like emerging market debt or high yield," Haslip said.

Credit cycles

The second area that Haslip spoke of, is around where we are in the credit cycle.

"We're getting closer to the end of the credit cycle and, if you think about the US market, we might be two or three years away from a potential recession in that market. Perhaps Europe and the UK are a little bit further away but insurers are thinking more and more carefully about what their exposure is to credit risk across the portfolio and how to position that to be less sensitive.

"That's thinking about things like high yield exposures, thinking about BBB exposures, thinking about scenario testing and what the impact is if there are some financial downgrades of BBBs to high yield."

Head of international fixed income insurance Prashant Sharma also touched upon the credit cycle.

"I think, importantly, in terms of conversations we have had with clients, the focus is very much on investment-grade corporate credit. That's the biggest part of the balance sheet for most insurance companies, the biggest social risk."

Sharma addressed the need to have a deep bench of credit research analysts, so as to make sure that anything with a deteriorating credit portfolio is avoided.

"The second focus for me has been around stress testing portfolios. We've done a lot of work around that, not just related to credit downgrades but also Brexit. Portfolios can be impacted from a capital perspective, and that's both in the market value impact on the portfolio but also ratings impact on the portfolio. There is an accounting impact also. So, for insurance companies that have incorporated IFRS 9, for example, you have this concept of expected credit loss. You have to take your current portfolio and check forward expected losses."

Regulation

From an equity perspective, Haslip outlined the regulatory changes occurring in this area.

"I think the key one is really around long-term equity investments. As an insurance company, if you hold listed European equity for more than five years in your portfolio, you can hold it at a 22% capital charge, rather than the 39% charge. I'm not entirely sure this is going to be massively useful because equity is an area where you generally want to be fairly active. So, a buy-and-hold strategy isn't necessarily the approach that every insurer is going to take and I'm not expecting to see lots of insurers now conducting five year plus holding periods for equities. I think most would prefer to be more tactical and look at other mechanisms to dampen some of the capital charges that are associated with equities. For example, hedging downside risk using options, or building collar strategies. The five-year holding period is interesting, but I don't see it as being a change that many insurers are going to take advantage of."

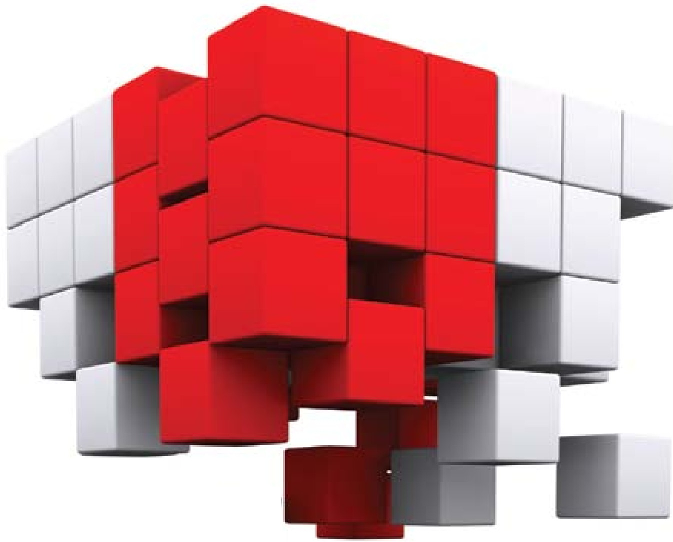
Haslip said the most pleasing change in regulation is around risk mitigating techniques.

"Currently, if you have hedging instruments that are being used, with less than one-year tenure, then you have to have a policy written around how that's being put in place and to make sure that it's always going to be renewed.

"But there was a minimum tenure of three months that had to be applied. So, for example, if you were using FX forwards and you wanted to make a US dollar equity investment as a euro insurer, you want that hedged back to the euro. The manager that you pick has to use three-month tenure FX forwards in their hedging programme to make sure that there is full FX capital mitigation for that hedge. That was actually quite cumbersome in practice because, for example, if you looked at the passive indices for what a euro or sterling hedged US large-cap equity investment looks like, the passive indices use 1-month FX forwards, they don't use three-month forwards. Industry practice has always been to use one month, so they are actually reducing the minimum tenure from three months down to one week. This means that there will be a lot more flexibility to build in hedging strategies and that goes beyond FX forwards. If you want to use equity put options to hedge the downside risk, you don't have to go for three-month or longer tenure. You can roll shorter term if you think there is greater efficiency in that part of the market and it will make it easier to invest in foreign denominated assets."

ESG

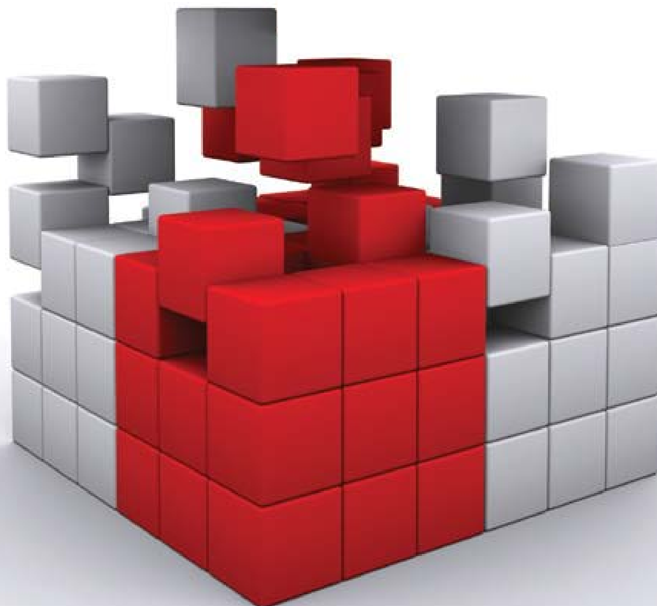
Focusing on ESG, Sharma said there is variability in sophistication among insurers. Dutch clients and Nordic clients, Sharma said, are a lot more sophisticated, with the UK showing increasing levels of interest. ESG continues to be very important for JPMAM and great strides have been made integrating this into its fixed income platform. Putting client's interests first means recognising and managing the investment risks and opportunities associated with ESG factors. Through its engagement and partnership with clients and various organisations, JPMAM continually refines its knowledge and views on key ESG issues and best practices.



Finding the right model

Lynn Strongin Dodds looks at just how beneficial internal models are under the Solvency II regime compared to standard models

WRITTEN BY **LYNN STRONGIN DODDS, A FREELANCE JOURNALIST**



Last year, the European Insurance and Occupational Pensions Authority (EIOPA) published its first study on the modelling of market and credit risk. There were significant variations in terms of outcomes due to different methods within internal models under Solvency II. While there will be further comparative studies, painting a more detailed picture will not be easy given the different methodologies being used.

"The scope of the review was to understand the modelling approaches being taken by companies using internal models for their market and credit risks," says Gerard-Jan van Berckel, head of delegated solutions, European Insurers at Aon. "The main components of market risk are interest rate -, equity -, property – and currency – risk, while credit risk is split into three components, default -, mitigation -, and spread – risk. The report's conclusions centred around the fact there was some divergence in modelling approaches and results and that this would be an area that EIOPA would monitor going forwards.

These issues were also reflected in a survey published by PwC in 2018, which focused on the UK life insurance market. It found while there was stabilisation in the calibrations of the major risks, life insurers were also not all on the same page when it came to adjusting a given risk or converging on a particular level of stress. Models and their outputs were still tailored to the individual businesses and their

risk management policies.

Moreover, the PwC report highlighted that the modelling of credit risk in particular varied markedly between survey participants with new statistical distributions adding to the wide array of models. It is one of the more common areas where refinements to the methodology continue to be made. However, there is little consensus in how the calibrated spread stresses changed over the year, either in direction or in magnitude, but the average stress for a 10-year A-rated bond increased for both financial and non-financial bonds.

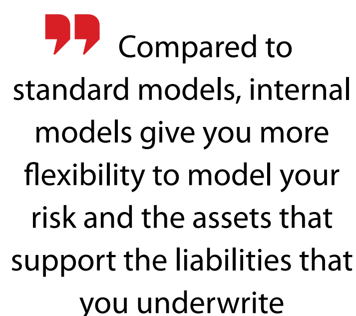
These findings perhaps are not surprising given that the insurance community is heterogenous and firms have their own specific requirements and risks based on their particular lines of business. For example, a life insurer has a different product range and set of risks than its non-life counterpart. In addition, national regulators are responsible for implementing Solvency II and many insurers are calculating their capital requirements and valuing their liabilities along country lines. This only widens the gap further.

Benchmarking

As a result, given the backdrop, some market participants have questioned whether benchmarking is a valuable tool to compare and contrast the various players. The EIOPA benchmarking exercise has pros and cons, according to Andreas Maerkert, chief risk officer at Hannover Re. "While it may provide some insight to regulators on the difference in calibrations used by insurers and reinsurers, it may also drive towards a one-size fits all approach with inherent systemic risk,"

Hannover Re is part of the Reinsurance Advisory Board which also includes six other heavyweight reinsurers, including Gen Re, Lloyd's of London, Munich Re, Partner Re, Scor and Swiss Re, with Insurance Europe as the secretariat. It recently published a paper which fully supports ensuring internal models remain credible to meet regulatory requirements, but outlines its "significant conceptual" issues with benchmarking exercises.

The RAB argues there is a risk that "undue harmonisation disconnects an undertaking's regulatory capital measure from its actual risk profile, raising the concern that it would no



> Compared to standard models, internal models give you more flexibility to model your risk and the assets that support the liabilities that you underwrite

longer be an internal view of risks." It believes that in fact the variation in risk assessments across the market is beneficial for overall financial stability. This helps to mitigate "the potential risk of employing overly similar models which can lead to the same conclusions. Moreover, looking at certain risks in isolation makes it difficult to gain a holistic understanding of the materiality of different risks, their ranking and interdependence, according to the trade group.

RAB also complains about the lack information regarding the methodology and tools used

by EIOPA to conduct its benchmarking studies. It said it encourages and "welcomes greater transparency to allow companies to understand and, if necessary, challenge how comparisons are made."

Although EIOPA may shed more light into its practices in the future, it is unlikely to abandon its benchmarking course of action. In fact, the comparative study is the first step in an ongoing process of monitoring and comparing internal market and credit risk models. This is mainly due to its concerns concerned over model drift which occurs when an internal model gradually no longer reflects the risks that the firm is exposed to.

These fears were also recently voiced by the Bank of England's Prudential Regulatory Authority. Speaking at the 2019 Prudential Regulation Seminar of Association for British Insurers, PRA head of insurance supervision David Rule said there was a worry that the capital requirements being generated by UK life insurers' internal models in particular were diverging too much from the requirements being generated by the standard formula.

PRA

The PRA measures model drift by comparing an internal model against the Solvency II standard formula and net best estimate of liabilities, as well as comparing movements in the model against the balance sheet. In the 2016/17 period, general insurers using internal models were in line with the standard formula and best estimate of liabilities. This was not the case though for life insurers where these two measurements rose in contrast to internal model capital.

At the moment, the PRA has decided not to take any action

but to closely monitor the situation. Rule attributes this to partly only having two years of data to analyse and also because some of the difference could be explained by changes to the insurers' business models. However, he warned: "The significant reduction in internal model capital compared to the standard formula is not a trend we would expect to continue over time. We will be watching it carefully."

While the EIOPA study may have divided opinions, all agree that the study is useful as a fact-finding mission that looks more closely at the inner workings of the internal models being used. "I think the regulator wants to have a better understanding of how these risks are being quantified at different insurers and what constitutes best practice," says Gareth Sutcliffe, head of Willis Towers Watson's Insurance Investment Solutions Group. "They can learn in more detail about what these firms are doing and how prudently they are acting."

Firms under Solvency II have to apply for permission to use an internal model to calculate their capital requirements. These models are highly complex, comprising of both quantitative and qualitative elements. The models aim to estimate the amount of capital needed to protect the insurer against losses in a '1 in 200' scenario over one year. Overall, the insurance capital model framework encompasses the whole balance sheet and estimates overall capital requirements, taking into account assumed diversification benefits across different risks.

The time and resources required to develop these models explains why as Sutcliffe notes it is typically the larger insurance companies which have the resources that have adopted the internal models while the smaller firms have stuck with the standard formula where the parameters are pre-set to calculate their capital requirements.

The UK has 24 insurers using the model – the highest number any EU country. The advantages, according to Sutcliffe is that it allows insurers to take better decisions because they have a more granular view of their capital versus using a standard formula. There are also diversification benefits in terms of risks and asset classes.

> Standard models are not designed for global and complex business models such as reinsurance

van Berckel echoes these sentiments. "Compared to standard models, internal ones give you more flexibility to model your risk and the assets that support the liabilities that you underwrite – which means that, in most cases, you can create greater diversification with different asset classes," he adds. "In most cases too, this enables the underwriter to enjoy lower capital charges and an investment portfolio that delivers better risk-adjusted returns.

Maerkert also adds that although "developing internal models is a challenging process, they provide a better risk measurement for large re/-insurers. The standard models are not designed for global and complex business models such as reinsurance."

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PAUL WHELAN
Fixed Income Manager Researcher of the Year, Aon

Paul is UK head of fixed income manager researcher for Aon. He is responsible for covering the full spectrum of fixed income asset classes and is an active member of the UK fixed income views team, working to expand the breadth of the team's output, formulating appropriate scheme hedging levels and informing the advice we give to clients on managing their liabilities.

ANDRES SANCHEZ BALCAZAR
Head of Global Bonds, Pictet Asset Management

Andres joined Pictet Asset Management's fixed income team in 2011. Before joining Pictet, he was a senior portfolio manager for Western Asset Management Company Ltd for six years. During his tenure he was responsible for global, European and absolute return fixed income portfolios. Prior to that, he worked for Merrill Lynch Investment Managers.

TOM BALAAM
Investment Manager, MS Amlin

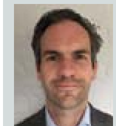
Tom joined MS Amlin in September 2013 from Lloyd's of London, where he helped manage fixed income portfolios. Starting from an analyst role, Tom is now an investment manager in the multi-asset portfolio management team at MS Amlin. His responsibilities include asset allocation, macroeconomic analysis and portfolio construction.

IAN COULMAN
CIO, Pool Re

As chief investment officer, Ian is responsible for the development and implementation of investment strategy, strategic asset allocation and the monitoring of the range of managers through whom Pool Re invests. Prior to joining Pool Re, Ian was managing director of Butterfield Asset Management, a wholly owned subsidiary of Butterfield Bank.

CLARENCE ER
Senior Life Consultant, Hymans Robertson

Clarence is a senior consultant in the life and financial services practice at Hymans Robertson, specialising in the fields of insurance investment and risk & capital management. He is a life actuary with over eight years of experience across industry and consulting. Clarence has also worked on insurance models used to value various illiquid asset classes.



NEIL PARRY
Portfolio Manager, Beazley

Neil joined Beazley in 2014 and is responsible for the management of the investment grade fixed income portfolio and the selection and oversight of external fixed income managers. Prior to that he worked in a similar capacity for Beazley subsidiary Falcon Money Management. Before this, he was a trader in credit derivatives at CQS, a London based hedge fund.

DEMYSTIFYING ABSOLUTE RETURN FIXED INCOME

CHAIR: Where do you see markets at the moment, and what are your views on fixed income?

BALCAZAR: We've been through what we would qualify as a risk on year. A lot of people are calling it the FOMO rally, because not a lot of people are convinced that this is the right time in the cycle to actually have such a stern rally in risk assets. We tend to believe that actually, right now, we are in a sweet spot for our markets, mainly because Central Banks across the board have moved away from the position they were at the beginning of last year. We also have the added potentiator that the Chinese Central Banks and the Chinese Government, are very much engaged in to achieving higher growth in China. From a policy perspective of the markets, it is a very constructive feeling at the moment. From a growth perspective, it is probably less so. I think from a fixed income perspective, having mediocre growth and mediocre inflation, is actually also a pretty good situation to be in. We like things to be stable, growth to be not too hot, not too cold, and inflation low, even though you could argue that you may have some rises in certain areas. From a fundamental perspective, there is also a fairly benign set of conditions, where probably there are some concerns round the more idiosyncratic stories, in particular in the emerging markets, and obviously everybody still quotes Brexit, the trade war, and so on as potential risks.

The risks have not changed a lot over the last year however. We do believe that one of the consequences of this risk rally, is that volatility seems to be too low for this stage of the cycle. We tend to deploy our hedges more on the tail risk side. We try to run a fairly balanced portfolio, so we do still like some of the duration markets on the risk off side and the US is one of these. Not because we think the US is going into recession, but because we've been through a rate hiking cycle already in the US. The Central Bank is signalling that they're pretty much done for the moment. The risk for us, is that obviously if we are to be constructive on risk, that the growth falters and therefore the Central Bank could need to cut rates. It's quite instructive to see that the Fed is telling everybody that they're happy to incorporate external factors into the rate decision mechanism. This Fed doesn't want to cut too quickly, they want to stay on hold for as long as possible. The lesser conviction we have is in the dollar. If somebody put a gun to my head I would probably be in long dollars. Why? Because everybody wants to be short, and it seems like the easy decision to make. People forget that usually the dollar tends to do very well when global growth underperforms. If your risk is as we said before that global growth underperforms, I think the contrarian should be looking to increase a dollar position not decrease it, which is very counterintuitive given that the dollar has already done very well over the last year or so. But, currencies tend to deviate for a very, very long time around central value measures, and they tend to follow the flow of money more. In terms of spread sectors, we like US long duration credit and we like parts of the emerging market credit. We'd still like to have some allocation to hard currency in emerging market sovereign, acknowledging that it has done extremely well right from the beginning of the year.

CHAIR: When you discuss those views against the backdrop of volatility

FRANÇOIS JOLLY
Senior Investment Manager, Lloyds of London
François's primary responsibility is managing fixed income investments across the Lloyd's capital structure; Central Fund, Premium Trust Funds and Funds at Lloyds. He is also responsible for all Foreign Exchange trading activity at Lloyd's. François has over 15 years' experience in trading and investment management roles.

which is lower than one might expect towards the end of the never-ending cycle, what sort of timeframes do you look to operate the views that you have mentioned, and has that timeframe shortened compared to where you typically would be on your investment horizons?

BALCAZAR: I think, given what's going on in markets, there's a tendency probably to shorten your time horizon and we want to fight that and remain focused essentially on a 3-5 years time horizon. We want to just remain steady in terms of how far ahead we look. In particular, we've just been through the end of the rate hiking cycle in the US. There's this natural tendency to try to predict the timing of the next cut or next hike, which I think is a losing game. If you stay with a focus on the long term, you realise that obviously what we are seeing is no different from what we have seen over the last 15 or 20 years, with the Fed consistently underperforming the expectations that the market has set, in terms of how much hiking they can actually deliver. It's mainly for structural reasons that this is happening.

I think one of the areas of concern longer term then, becomes that the priority is no longer for governments to reduce their levels of debt. If anything, it's the opposite. How can we ease fiscal policy further? So now you get the likes of the modern monetary policy theory coming in.

I think that's a good debate to have, but it has to remain on the longer timeframe. We're trying to avoid the temptation to try to forecast too much what's going to happen near term. We don't believe that you can have a repeatable edge in trying to forecast what the next quarter GDP number will be, but what I can tell you longer term is on average that GDP is going to underperform the estimates that people have around GDP trends in the world. That's one long term consideration, the size of government balance sheets is another one.

CHAIR: So the key points of investing in this environment are around capital preservation and liquidity, enhanced returns irrespective of the market cycle but to deploy those techniques, any absolute return strategy must involve a longer term philosophy.

> There needs to be a notion that the client is getting a good value proposition mainly from the downside protection, and close to beta returns during those more favourable years

BALCAZAR: That's a very fair summation, I think. One clarification I would just make, is when you say 'go anywhere, do anything' under an absolute return strategy, people assume that the strategy will perform well in whatever market scenario it is faced with. That's a bit pretentious from my perspective. If you say we're going to do well in every single market scenario, it's a very tall order. What we're prepared to do, is to say to our clients, that we're going to give the, downside protection during difficult fixed income years, and last year is a good example of this. We had positive returns of 1.5%. We did underperform cash last year, but during the more positive years like this one, we can deliver higher than target returns for our clients. So on average, over the longer run, I would say cash plus three. It's important to note that when you call it absolute return, there needs to be that embedded notion of what you call capital preservation and the downside protection around the strategy. For the future survival of these type of strategies, there needs to be a notion that the client is getting a good value proposition mainly from the downside protection, and obviously when the beta is doing well, then close to beta returns during those more favourable years.

CHAIR: There are some strategists that think they can deliver positive

terms every single day and have 300% to 400% turnover per year, versus others such as yourselves which work around more longer-term thematics.

BALAAM: We are an investor in absolute return fixed income. Our portfolios have short duration liabilities, so the need for liquidity is high. We already have fairly large allocations to Treasuries, short fixed income and short credit portfolios. We use our allocation here to increase portfolio diversification. We find within the absolute return space, you can construct portfolios with relatively low correlation to interest rate and credit risk.

PARRY: What we have found particularly in the volatility controlled strategies which potentially is what you're offering, is that they are inherently more correlated to our existing exposure to front end rates, and the front end of the credit market than other strategies. Other strategies aren't as effective so much on the downside. We're more willing to look at absolute return, that is completely agnostic to where it goes, and may have quite material exposures if you take them individually, and could potentially underperform on the downside in a bad year, but then would catch up more on the upside in good years.

ER: From an insurance company perspective, demand is likely to depend on the type of insurer and liability. For annuity liabilities, assets are held directly on the balance sheet and there is a focus on sourcing long-dated fixed income and long-dated inflation-linked assets to back their long-dated liabilities. Then we've got with-profit funds, many of which have a high allocation to equities. They may consider strategies like absolute return fixed income for the non-equity portion of their portfolios, but the suitability will vary from fund to fund - for example some are more mature than others, and some are better capitalised than others- and their investment decisions will need to reflect policyholder expectations and commitments. As we've just discussed, some non-life insurers have already invested in absolute return fixed income strategies. Here, liquidity is a key consideration, and also portfolio durations are shorter than we typically see for life insurers. The extent of overlap with what the firm is currently investing will also need to be taken into account. One final thought is that life insurers may be looking for suitable assets to back their 'surplus assets'.

> We find within the absolute return space, you can construct portfolios with relatively low correlation to interest rate and credit risk

Similar considerations may apply here in terms of liquidity, duration and diversification. Regardless of which type of insurer and which type of liability class, some key challenges will include understanding the underlying risks of the investment and, of course, being able to model it.

COULMAN: We don't invest specifically in absolute return fixed income, but in a roundabout way we do have exposure to different strategies underlying this. I'm a little bit sceptical because absolute return strategies are almost too broad in nature. It's almost 'go anywhere' in fixed income markets to try and capture that value.

JOLLY: From our point of view, we actually put money towards absolute return fixed income this year, but the strategies ranged quite significantly. At the end of the day, we actually went with a manager who had less correlation to what we do already. Some of the more credit focused absolute return funds had too much correlation like to what we already do.

I do think there is a case for absolute return fixed income strategies, given

we are seeing equity markets again achieving all-time highs. Credit spreads are again nearing post global financial crisis lows. Personally, I hate the name of absolute return though. It reminds me of a LIBOR plus 100, plus 200, plus 300 and so forth. I see this allocation as I see hedge fund allocation. It's all on the manager.

BALCAZAR: If the absolute return portfolio turns out to be a lower beta version of your traditional portfolio, I don't think we are doing our job properly. I think for a good absolute return manager you need to be very aware of correlation and actively manage the correlation risk. I think a manager who's not aware of correlation, and isn't actively managing that correlation, is probably not going to give you the downside protection. You also need to be very aware of how that volatility is priced in the market.

The complexity point is a very good one. It's all about a process in this portfolio. How do you reassure the client what kind of risks they're taking? How do you know that the risk that you're taking is exactly what it says on the tin? I think that's why we make a lot of reference to the structural themes in our case. We are very clear that if the client doesn't understand what's driving the returns in their specific absolute return fixed income portfolio, then they're very unlikely to renew this with you. You need to be almost systematic about the way you take risks, and very, very disciplined in your investment process. Even in periods where you might think your investment process may not work, that credibility is far more important. I think that's absolutely key. Somebody who has a strong process, who's reputable, who can actually show with evidence that they have followed the process is particularly important.

COULMAN: Do you think the development of machine trading is going to reduce the opportunity set for absolute return fixed income managers?

BALCAZAR: In a way, yes, because it makes it the barriers to entry in that ecosystem harder. With the amount of technology and machine learning that is out there, it would be very pretentious for somebody who's starting from scratch to say that in three years we'll have a high frequency trading activity. I think that the differences in skills and technology there are massive. It goes from not only the algos, and obviously the computer and brainpower that you have, but it goes to the access to the markets that you have. That's why we made our very conscientious decision about how we are not going to compete in that space. In a way,

> I think for a good absolute return manager you need to be very aware of correlation and actively manage the correlation risk

the opportunity has been created because there is a vacuum that has been created from the trading, where there is a lot less capital for trading activities. That vacuum has been somehow filled by the asset managers and insurance companies who can provide liquidity to the market at those times.

PARRY: You said you really like long-dated credit, and the credit curve is steep, looking ahead beyond five years from now. How do you capture that given the lack of liquidity, and do you use ETFs to do it?

BALCAZAR: We cannot use ETFs in our absolute return strategy. We wanted to make it as transparent as possible. One thing is the ETFs are equities so we say we cannot do that. If you think what has happened over the last 15 years in the market, there's this massive growth in the ETF business and the passive business. In a way, it's actually a good thing for active managers. It actually makes your job easier because there's less competition for those active strategies that really work. For me, it's actually a bit of a blessing in disguise. Yes, of course my fees are going down, and I'm losing assets to passive investors, but I actually, as an active investor, think there are more opportunities now, than what there were before the global financial crisis when everything was arbitraged. Going back to your question on how you exploit that long duration credit, the thing the additional complexity is to make the clients understand that that's how you separate your decisions. You use derivatives to separate your spread decision from your rate decision, from your currency decision.

PARRY: Do you hedge your duration?

BALCAZAR: Yes, but again, there goes an extra layer of hedging because if you hedge the bond on a one-by-one basis on duration-by-duration basis, you're actually taking a pretty active beta - spread beta decision. It depends on the correlation between the spread and the rates which is not always stable and not always positive. That's why I said at the beginning, the manager that is very aware of correlation would know that.

CHAIR: Looking at alternatives, whether it's direct lending or real estate debt, where does that fit into your portfolio just from an insurance perspective if at all, and how does that compete versus some more higher octane absolute return fixed income?

Balaam: In terms of alternatives we have an allocation to global property. In terms of other alternatives, we've looked at the space in terms of direct lending etcetera but you're just upping your liquidity risk. We have property which is illiquid in the capital portfolios. How does it fit in with these strategies? I mentioned before we used that as part of our liquid part of our portfolio. In terms of going down the route of higher-octane fixed income, that's not what we are looking for in our absolute return fixed income allocation. We have equities if we want to increase risk levels rather than do this via the fixed income allocation.

PARRY: We absolutely invest in alternatives. Again, we have a bucket of illiquidity where we're willing to allow funds to be locked up for longer and that's a mix of hedge funds and some direct lending strategies. Particularly direct lending, I don't think it's as advantageous now as it was maybe three or four years ago. It seems like those returns are getting much lower much more quickly. I think there is a lot of capital that is looking at that, and I think that some of those funds are levering further to get the same return as they would previously earn with less or no leverage.

ER: We've seen growing interest from firms in recent years to support them with strategic asset allocation. There are many reasons for this - the low yield environment, competitive markets, and also more focus on investments now that Solvency is embedded. For the bulk annuity market, 2018 was a record-breaking year and 2019 looks set to be another big one, so there is a big demand for alternative, long-dated assets - we've seen firms investing in infrastructure debt, real estate debt and equity release mortgages. Elsewhere we have seen firms investing into areas such as high yield, private equity and emerging markets - although in some cases holdings in these asset classes are still small relative to traditional asset classes.

COULMAN: Obviously the alternative risk premium is quite liquid, but there are other areas that we've either considered or continue to monitor. This has included real estate debt, infrastructure debt, private equity, private debt and trade finance. A number of different areas there. What is always critical from our point of view is the liquidity side of things. We have thought about real estate in the past as

to whether we move directly into real estate and property, or through REITs. REITS typically are too correlated to equities.

We have talked about being close to the end of the cycle and it having been extended. Is it really the right time to be taking on additional risk?

JOLLY: I still have nightmares about selling illiquid assets in the 2008 financial crisis, and so I'm much more liquidity driven.

Balcazar: I think of course from the absolute return perspective, liquidity is one of the priorities. On the other side, what's amazing is on all the areas as much as we can say in terms of the stage of cycle we're in, is how much money is actually chasing so few returns.

CHAIR: Is there any other questions panellists want to raise, or topics they want to bring up?

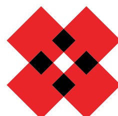
JOLLY: I think my issue with asset returns is it's very difficult to benchmark. For example, there are a lot of Absolute asset return funds that have a benchmark of cash plus 100 basis points.

BALCAZAR: I think the benchmark being brought into question is an interesting one. I think we need to be very aware of where beta is. On your question regarding how do we tackle, let's say, the asymmetry of the client reaction, I think for us it's very clear. If we're underperforming, and if the client even before talking to you, already knows the answer that's a good sign. The calls you hate to answer is, hold on, I thought you would be doing well in this type of environment. How come you're not? So you know your communication was poor from the outset, or you're actually not doing what you said you would do, which is even more serious. I think there, the trust bond is broken and trust is a very, very important concept. You don't have a benchmark, you don't have a way of guiding; you just have what you say you will do, and that's it. For the survival of the asset class or the sector, I think managers need to be very aware that 'go anywhere' doesn't really mean 'do anything' in the absolute return fixed income space.

> For the survival of the asset class or the sector, I think managers need to be very aware that 'go anywhere' doesn't really mean 'do anything' in the absolute return fixed income space

PARRY: The other problem is that the track record is short with lots of these funds because the asset class itself is just new. If you look at a bond index you can go back 50 say- or however many years you want. With absolute return fixed income the track record is short.

BALCAZAR: I think 2018 was a very good test for managers in this field in general. I think the market has been very quick and taken out some of the competitors, sometimes very quickly. I think we're in the middle stage of the development of the asset class. One of the reasons why we decided to go there at Pictet as some of you who know is that we try to be niche players in some areas, rather than just being everything for everybody. We identified that as one of the niche areas that we would want to develop. This is skilled, and not everybody has the capabilities or the skillset to do so.



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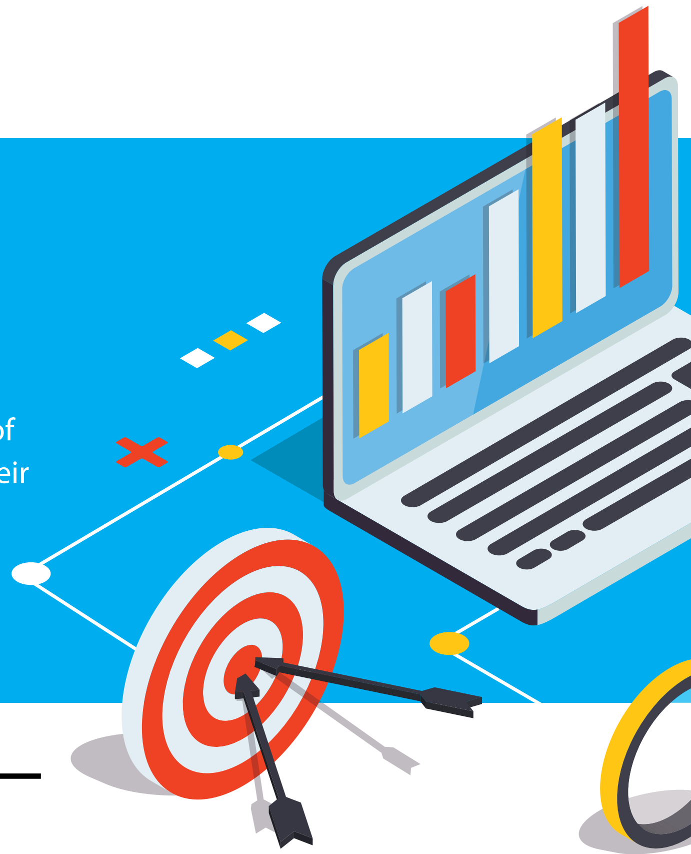
Data driven

With an increasing number of compliance requirements and an ever-growing volume of data, how are insurers using technology to their benefit? Michelle Stevens reports



WRITTEN BY **MICHELLE STEVENS, A FREELANCE JOURNALIST**

The onset of the digital era has made technology more prolific in our everyday lives, and technology that has been bought for consumer purposes can also have a knock-on effect on how insurers operate. People are able to engage more with their health and activity levels through fitness apps and wearable devices, which in turn provides more modelling data for health and life insurers, while emerging technologies such as driverless cars could open up a whole new field for motor insurers. But aside from the consumer technology enjoyed by policyholders, how are insurance firms themselves benefiting from advances in technology when it comes to their own internal systems?

Solvency II

Arguably the biggest change to insurance regulation for several decades, Solvency II came into effect in January 2016, covering three key areas: valuation of assets/liabilities and capital requirements, governance and risk management, and reporting and disclosure.

Naturally, this has raised the compliance stakes in all of those areas, putting the spotlight on how insurers' systems can handle all of the processes necessary to accurately capture, analyse and model data, as well as govern and report it.

"Insurers are utilising technology to help comply with all three pillars of Solvency II," explains Lisa Henderson, principal and InsurTech strategist at Milliman. "New software has been developed to support standard formula calculation and analysis, quantitative reporting enterprise, risk management, capital allocation and estimation methods for solvency indicators.

"Most insurers feel that the cost of compliance with regulations is a high-cost/low-return proposition," she argues. "However, in order to fulfil requirements for Solvency II, insurers have had to invest in new applications that allow the business to meet reporting and compliance requirements. These investments into back-office functions and internal processes have enabled insurers to streamline workflows and improve efficiency."

This assertion is echoed in the findings of a global CIO survey conducted by KPMG and Harvey Nash last year, which included responses from 200 IT leaders in the insurance sector. It found that 30 per cent of those respondents felt that their organisation had been "very or extremely effective" at using digital technologies to improve business process efficiency – higher than the average of 28 per cent polled across all other industries.

Indeed, investment in technology originally designed to meet the wide-ranging requirements of Solvency II

> In order to fulfil requirements for Solvency II, insurers have had to invest in new applications that allow the business to meet reporting and compliance requirements

could be a springboard to realising other business benefits.

"More forward-looking insurers are now utilising the data, modelling and analysis frameworks developed for Solvency II for a greater purpose," notes Phil Mowbray, senior director of insurance modelling and analytics at Moody's Analytics. "In particular, these help to provide greater insight into the risks and capital requirements associated with business lines, and to assess the impact of management decisions across M&A, investment strategy, product development and other areas."

Portfolio management

Mowbray adds that the implementation of Solvency II and the current low-yield environment are "creating challenges" for the establishment and management of insurers' investment strategies.

"To add value, investment decisions may need to be processed with aggressive timelines of hours or days, not weeks," he says. "Traditional return-based portfolio risk models are not capable of addressing the complex path-dependent asset liability modelling problems facing insurers. Enterprise actuarial systems built for financial valuation, reporting and pricing are often too cumbersome to support ongoing investment planning and strategic asset allocation activities.

"As a result, insurance asset managers are looking to new portfolio analysis and asset allocation systems that use scenario-based risk models to capture both assets and liabilities," Mowbray continues. "These systems allow investment strategy decisions to be assessed quickly and communicated in the wider context of business stakeholders' objectives."

Robert Kubin, chief investment officer of Polish insurer PZU, agrees that technology is a "key enabler" in insurance company portfolio management.

"Solvency II has very much helped in this regard, as it quantified and standardised the risk component of the investment process, which lowered the level of personal judgement needed and brought objectivity," he explains. "As an example, various forms of optimisers are nowadays used in the strategic asset allocation process, which enable portfolio managers to make valid investment decisions. Another important aspect is the standardisation of investment processes in large insurance companies, which has enabled the gradual automatisation of various repetitive tasks."

This automatisation has sped up processes, which, combined with better quality data and analysis techniques, is benefiting insurers' asset management operations in general. Iain Forrester, head of insurance investment strategy at Aviva Investors, notes: "Advances in technology mean that insurers can now manage balance sheets with a much greater level of precision than before. When this is coupled with better data and well-conceived analytical tools, there is suddenly much more information to hand about your portfolio, all of which can be processed at a faster rate.

"We've been able to use this to provide clients with more robust information and analytics about their holdings, across both live and model portfolios, through our client portal," he continues. "Ultimately, this should mean that investment strategies can be implemented with an improved level of agility, helping insurers to better meet their overall objectives and outcomes."

New horizons

Although great strides have already been made in terms of expediting and improving internal systems in the context of modelling, reporting and investing, new technologies are constantly emerging, providing the opportunity to change or improve a variety of business operations.

Kubin believes that there is potential yet to be capitalised on: "With the further advancement of technology it will be possible to automate more and more processes, and artificial intelligence (AI) will be used not only to speed up processes or harvest Big

Data, but also to make valid [business] decisions."

This thought is also borne out in PwC's Insurance Trends 2019 report, where more than 80 per cent of the 140 insurance CEOs interviewed said that AI was already a part of their business model, or would be within the next three years. The report states: "Although the current wave of new technology investment focused first on improving customer experience and reducing costs, it is now shifting to new business models. The increasing use of sensors, AI and machine learning in combination has affected the practices of loss anticipation and compensation, moving them towards more proactive risk detection, intervention and prevention."

Henderson points to the untapped opportunities that an increase in digital strategy budgets could bring to the sector. "Technologies such as artificial intelligence have yet to be widely applied to functional areas like underwriting and risk management," she says. "Based on investment, insurance is still early in its transformation with technology when compared to other industries. The banking industry has invested close to $1 trillion in technological transformation, while the insurance industry has invested less than 10 per cent of that amount."

That sentiment is also reflected in the amount that was invested globally in FinTech and InsurTech companies in 2018, at $111.8 billion (KPMG) and $3.2 billion (FinTech Global) respectively. But there is certainly growing market excitement around the digital possibilities of the maturing InsurTech sector – whether that be for firms developing consumer-facing or enterprise insurance technology. In Q1 2019, InsurTech investors worldwide executed 85 deals with a total value of $1.4 billion, the latest figures from Willis Towers Watson show – with the deal count already 35 per cent up on Q4 2018.

> Based on investment, insurance is still early in its transformation with technology when compared to other industries

There is still some variability in the rate of adoption of newer sector technologies, according to Mowbray, but insurers are embracing many of them. "The availability of near real-time data and the technology to manage it has already had a fundamental impact on certain insurance sectors," he concludes. "These factors are likely to have a particular impact in health and longevity, with the growth of wearable technology and enhanced mobile connectivity. This Big Data – and the sophisticated machine learning knowledge that can be derived from it – will be key to the future of insurers' risk management and commercial success."

News from Lloyd's

Adam Cadle sits down with Lloyd's chairman Bruce Carnegie-Brown to talk about the world's leading insurance market

WRITTEN BY **ADAM CADLE**

Q Can you explain your background and how you have reached the position you are in today?

I spent the first 22 years of my working career in investment banking and moved into the insurance sector in 2003 as, first, CEO of Marsh's UK business and then CEO of Marsh Europe, Middle East and Africa. More recently, I have had non-executive roles on the boards of Catlin Group, Aon UK and JLT Group, so the combination of an insider's and outsider's perspective on the insurance market positioned me well to take on my role at Lloyd's in 2017.

Q How would you describe the health of Lloyd's at the moment in terms of profits and new business?

Performance in the insurance sector continued to be affected by the tough underwriting and investment market conditions in 2018.These were reflected in the Lloyd's market's 2018 results, which were impacted by above-average major claims activity and the low return investment environment. However, the result was underpinned by continued strengthening of the Lloyd's market's capital position and early signs of improvement in underwriting performance.

During 2018, Lloyd's put in place a series of measures to improve the market's competitiveness and relevance in the short, medium and long term.

Most importantly, this took the form of a rigorous performance management process to make sure business written in the Lloyd's market is profitable and sustainable. We continued to invest in our digital future, mandating electronic placement and piloting new ways of connecting with our clients, coverholders and brokers around the world to make Lloyd's easier to do business with. We enhanced our reputation for innovation by launching the Lloyd's Lab, which connects new products and services with capital providers and we also made Lloyd's Brexit-ready by opening our new subsidiary, Lloyd's Brussels.

Looking forward, the market's 2019 plans show syndicates are planning to write more than $7 billion of new and innovative business including cyber, sharing economy and parametric covers, which is very encouraging.

I am confident the work we began in 2018, and are continuing into 2019, positions Lloyd's for success in the years ahead.

Q How has Lloyd's prepared in the face of Brexit?

The biggest challenge created by the Brexit process is uncertainty which makes planning and investment very difficult.

That's why at Lloyd's we determined very early on that whatever happened politically we were going to make sure we had a solution in place that means

our brokers and coverholders and ultimately our policyholders can have access to our products and services whatever the deal – or no-deal – that is finally agreed

That solution was to create a European subsidiary, Lloyd's Brussels, which opened for business on 1 January 2019. This gives everyone who works with us the security that however Brexit plays out they can access our products and services in the way they always have. Claims, accounting, settlement – all our processes remain the same. We also think that having a presence

in the heart of Europe will help us grow our business there.

Q The combination of new risks, economic upheaval and evolving technology is putting the insurance industry and its competitors under more pressure than ever. What are the impacts of this on Lloyd's and what is it doing to address these challenges?

This is certainly a time of great challenge but we also see this as a time of great opportunity. As I mentioned earlier, a number of factors have put pressure on profitability, but they have also made us rethink how we do things. How can we drive down the costs of doing business by digitising processes and IT legacy systems? How can we supercharge innovation, using data and dynamic pricing to create new products and services that are closely aligned with customers' risk needs? How can we make our market more accessible for our customers? How can we improve our customer's experience of buying insurance protection? And how do we reshape our workforces, so they support a different type of insurance sector?

On 1 May we launched a consultation that sets out various possible options to answer these questions and to build a Lloyd's for the future. This document, *The Future at Lloyd's*, includes ideas like a risk exchange through which customers' standardised risks can be placed in minutes at a fraction of today's cost, an automated claims process that speeds up settlement to improve customer experience and increase trust in the market, and a flexible capital structure that makes it simpler for capital to attach to risk. They are ideas that combine the best of

> **This is certainly a time of great challenge but we also see this as a time of great opportunity**

Lloyd's with new technology and capabilities.

There are about seven weeks of the consultation left to run and the results will feed into a blueprint. From there, towards the end of the year, we will start building solutions.

Q How are Lloyd's investment portfolios positioned to address economic volatility?

Our approach to investment management at Lloyd's is driven by risk appetite rather than a target return objective. In this way we focus on capital preservation over the longer term to safeguard the Central Fund for policyholders.

Our strategic asset allocation ensures that Lloyd's portfolio is well diversified by investment risk drivers. Our investment managers are constrained by set parameters and guidelines and actively manage their portfolios to protect against downside volatility. The portfolio is continually monitored and regularly assessed against risk appetite criteria.

Q Climate finance lawyers at ClientEarth have put Lloyd's of London on notice of legal and financial risks associated with Adani's Carmichael coal mine. What is your stance on this and the whole ESG debate?

A search of our records has not

Editorial credit: / Shutterstock.com

identified any direct syndicate involvement with the Carmichael mining project. We are therefore satisfied that to the best of our knowledge the Lloyd's market is not knowingly involved with the project currently.

That said, while the insurance industry can effect change through the underwriting decisions it makes, we prefer to do this by working constructively with our customers rather than by withdrawing from insurance altogether.

While coal and other hydrocarbons remain a substantial part of the global energy mix we have a responsibility to help companies manage their risks, and to ensure policyholders and the public are protected by paying claims when we need to.

At the same time, we also support sectors and technologies that are helping society transition to a low carbon economy such as the renewable energy and electric vehicle industries.

Our strategic asset allocation ensures that Lloyd's portfolio is well diversified by investment risk drivers

Q How important are China and the US to Lloyd's re/insurance market growth?

Both markets are very important in different ways. The US is our most important and largest market comprising 44% of Lloyd's global premium, which in 2018 accounted for $19 billion of premium income. Lloyd's is the leading excess and surplus lines market - Lloyd's share of the E&S market has grown from 21% in 2013 to 25% in 2018 - and third largest non-US reinsurer. Even though it is a developed market, there is still great potential for future growth. Lloyd's analysis shows the US (re) insurance market will continue to grow across all segments and major states, with Texas and California leading the way. In California, the E&S market could double by 2025.

In terms of China, at Lloyd's we took the decision over a decade ago that we needed to be there to take advantage of its emerging insurance market. Last year, Lloyd's China celebrated its 10th anniversary and we see a strong future ahead because there is a lot of market growth potential. For example, one study estimates that China's Belt and Road projects in countries outside China will generate an estimated $28 billion (RMB 192 billion) in commercial insurance premiums by 2030. We are well placed to compete for a share of that.

Current ponderings on industry themes

NIGEL GREEN
deVere Group
CEO

Following MPs' abject failure to so far find a way forward through the impasse, the next move has to be to have a second Brexit referendum in order to protect jobs and secure long-term, sustainable economic growth. First, it gives MPs a clear, unequivocal message either way, breaks the grinding deadlock, and reduces ongoing uncertainty. And second, it would increase the chances of a softer Brexit, which would have the effect of producing a relief rally in Sterling, UK financial assets, and also a spurt in economic activity in Britain, as delayed household and business spending is unleashed

S&P GLOBAL RATINGS

Most of our rated insurers might not be willing to use their full Solvency II hybrid capacity, even under stress, because the credit we give for hybrid capacity is on average 25% lower than under Solvency II, and could prove to be an additional constraint. We typically limit the hybrid ratio to up to 25% of TAC for insurers in Europe, the Middle East, and Africa. Under Solvency II, tier 2 and tier 3 hybrid instrument eligibility is capped at 50% of the SCR, while RT1 instruments are capped at 20% of Solvency II eligible tier 1 capital

PHILIPPE DONNET
Generali Group
CEO

Germany is for us a key market where we want to grow. With this transaction [sale of Generali Leben], we complete the industrial transformation of Generali Deutschland. We confirm our position as the second largest retail insurer in the German market and we reinforce our leadership in the Life Unit Linked and Protection businesses. The resources freed up thanks to the sale of Generali Leben will be redeployed to support growth

Energy investments now face unprecedented uncertainties, with shifts in markets, policies and technologies. But the bottom line is that the world is not investing enough in traditional elements of supply to maintain today's consumption patterns, nor is it investing enough in cleaner energy technologies to change course. Whichever way you look, we are storing up risks for the future

DR FATIH BIROL
IEA's executive director

CIVIL SOCIETY ORGANISATIONS

Regarding engaged companies, we call you [Aviva] to apply targeted and impactful engagement requiring them to adopt, within maximum one year, a decarbonisation target to gradually reduce their exposure to coal and align their business model with the UN Paris Climate Agreement, as well as to publish, within two years maximum, a clearly articulated and detailed implementation plan for the gradual closure (not sale) of existing coal plants and mines, exiting coal at the latest in 2030 in the OECD and in Europe, and in 2040 in the rest of the world. Finally, we call you to commit to divest from companies that fail to comply with these demands within the indicated timeline

Shareholders are advised that the board has had various engagements with Mr Peter Moyo, the OML and Old Mutual Life Assurance Company Limited (OMLACSA) Chief Executive Officer.

These engagements have caused the board to conclude that there has been a material breakdown in trust and confidence between him and the board

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