Insurers have experienced a prolonged low-yield environment as well as major regulatory disruption in recent years caused by the introduction of Solvency II and other regulation. In addition, events like Brexit have brought great structural change.

Rethinking what an optimal asset strategy looks like in these challenging times of low interest rates and macro risk is a non-trivial task that should be high on insurers’ agendas. EY Investment Advisory teams compiled a set of seven questions to consider when thinking about your investment objectives:

1. Could a deeper understanding of your liquidity position enhance returns?
2. What does your optimal asset allocation and ALM look like under Solvency II?
3. Is investing in alternative assets a change in investment strategy or the new norm for insurance investment?
4. Do you have a clear risk budget to take on risk in investments where this is appropriately rewarded?
5. Does your operational management framework allow your investment strategy to be as agile as your thinking?
6. Is your asset manager a partner or a product provider?
7. Are your investment objectives aligned to your responsible investment beliefs?
Could a deeper understanding of your liquidity position enhance returns?

Less liquid assets can offer an illiquidity premium, providing investors with higher returns. Deep understanding of your liquidity position allows you to divert from simply holding “cash-like” investments or other liquid investments to less liquid investments. Without this knowledge, firms tend to err on the side of caution. Are you investing in risk-free assets, or taking on a return-free risk – and can you do better instead?

What does your optimal asset allocation and ALM look like under Solvency II?

Optimal asset allocation touches on a wide range of balance sheet activity and is key to return on capital delivered to shareholders. What is optimal for a given firm depends on its target metrics, investor story and stated objectives.

An informal EY CIO survey showed that the majority of firms manage their investment strategy on a return on regulatory capital basis, although some manage their investment strategy on different metrics such as return on economic capital or a balanced managed fund approach.

Optimal asset allocation is also constrained by differing capital efficiencies of investments under Solvency II. With the asset side of the balance sheet exhibiting greater volatility and a greater rate of development along with differing optimization metrics, are you confident you have truly optimized your asset allocation? For example, are you currently considering a Solvency II optimal strategy (hedging BEL) or IFRS optimal strategy (balance sheet hedging)?

Is investing in alternative assets a change in investment strategy or the new norm for insurance investment?

The prolonged low-yield environment has pushed insurers to expand their allocation to illiquid and alternative assets. Early adopters are continuing to realize a clear advantage, and investing in such assets is becoming an increasingly popular option under Solvency II. We have also seen insurers widen the spectrum of what they consider appropriate alternative assets.

Respondents to an informal EY CIO survey stated that search for yield and availability of assets are two of their top three commercial pressures faced.

Is this the new norm for insurers, or is it only a competitive advantage of the bigger players that have the ability to execute such investments?

► Do you have the expertise to appraise these assets internally?
► Do you have the capacity to develop and monitor a pipeline of “hard-to-find” assets?
► Can your back-office infrastructure adapt to assets without market pricing or external research?

Do you have a clear risk budget to take on risk in investments where this is appropriately rewarded?

It is a well-quoted cliché that there is “no return without risk.” Risk management teams allow for positive risk-taking by setting clear limits and targets so that appropriate risks are taken within your investment portfolio. Market-leading insurers have upper and lower bounds around their risk appetite and welcome investments that appropriately reward investors for risk. This is facilitated with a strong relationship between risk functions and investment offices. Do these strong relationships exist in your firm between the first and second line, or is this interaction infrequent, stilted and jarring?
Does your operational management framework allow your investment strategy to be as agile as your thinking?

In a regulatory regime in which all asset decisions have an immediate balance sheet impact, agile decision-making and governance is key. To enable a quick reaction to opportunities, clear authority limits are required. Balance sheet management information also needs to be available frequently. If an opportunity arises, does your operational management allow you to react quickly enough to take advantage?

Is your asset manager a partner or a product provider?

Insurers are inherently complicated in nature. Asset managers that have a close understanding of their clients' balance sheets will be able to better serve their needs and form a true partnership. This provides a stronger platform on which to obtain target investment returns. How confident are you that your asset manager fully understands your strategy?

Are your investment objectives aligned to your responsible investment beliefs?

Achieving the right relationship between an insurer’s brand and its investments is a non-trivial task. Responsible investing and incorporating environmental, social and governance (ESG) analysis into decision-making provides such an opportunity for alignment. Have you considered your brand and responsible investment beliefs when defining your investment objectives so you can contribute to building a better working world?

How EY can help

Our European Investment Advisory team of 70 members has significant investment experience in life and non-life insurance, pensions, banking and capital markets, and asset management. Together, we work across disciplines to form the most appropriately diverse and connected investment teams in the market. Our broad range of skills allows us to provide investment-related advice on an extensive range of hot topics within the industry.

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Please do not hesitate to contact any of us if you would like to know more.

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