Asia Pacific Insurance Survey

The twin forces reshaping the industry

Executive edition

Standard Life Investments

July 2017

Executive summary

The global insurance industry is being reshaped by twin forces: historically low interest rates and the modernisation of regulatory regimes. Two years on from our research on the European insurance industry in the lead up to the arrival of Solvency II, we turn our lens to Asia Pacific. Standard Life Investments commissioned this in-depth research to identify the latest trends impacting Asia Pacific insurance companies and the implications for their investment strategies. We identify the pressures facing traditional business models and analyse the investment implications.

The research targeted Chief Investment Officers, Chief Risk Officers and Heads of Investment in six markets across Asia Pacific. These markets all have distinct characteristics and are at very different stages of maturity. The combined assets managed by the respondents are over $4 trillion, which represents an estimated 60% of the total Asia Pacific insurance market.

The research identified five themes that will shape the industry and influence the way that investments are managed.

Theme 1: Mind the gap?

A number of Asia Pacific insurance markets face immediate investment return deficits. Guaranteed products represent 51% of the asset mix of insurers surveyed. While a shift to investment-linked products is underway, all still face the challenge posed by low bond yields.

- Insurers in Japan, South Korea and Taiwan face an immediate return gap, with investment returns insufficient to meet the promises made to end-customers.
- Asia Pacific insurers face asset liability mismatches in both directions: short duration liabilities backed by longer dated assets and vice versa. Regulatory change means these mismatches will have to be addressed. This represents a particular challenge for mainland Chinese and Hong Kong insurers, who have generated strong returns from illiquid assets.

Theme 2: The dual role of alternatives

Insurers intend to increase exposure to alternative assets, while reducing exposure to domestic fixed income securities. Alternative investments not only provide higher expected returns, but include longer dated assets that better match longer dated liabilities.

- Cash, bank deposits and fixed income securities currently make up almost 71% of total assets invested, but our research points to significant asset allocations shifts.
- 78% of insurers intend to increase exposure to infrastructure, 75% intend to increase private equity and 64% are looking to add to real estate. Infrastructure debt was highlighted as an asset that offers both higher yields and longer duration assets.
- In general, solvency regimes in Asia Pacific require lighter capital requirements when investing in alternatives compared to Europe. In any case, insurers are often willing to seek higher returns from alternatives even if higher capital charges are required.

Theme 3: Global opportunities, local challenges

Insurers intend to increase international allocations in search of higher returns, better duration matching of liabilities and increased diversification. They have to overcome the hurdles of currency hedging costs, regulatory barriers and gaps in internal capabilities.

- 78% of insurers surveyed intend to increase international investment over the next three to five years.
- 61% cited hedging costs as a major barrier to increasing international allocations.

Theme 4: Trust in external managers?

Respondents intend to increase allocations to those asset classes where the use of external managers is highest: alternative assets and international equities. Yet the survey identified barriers – real and perceived – to increasing allocations to external managers.

- Respondents thought external asset managers were doing a good job, with 68% reporting that external managers were meeting their needs.
- 76% told us that increasing allocations to alternatives is likely to lead to greater use of external asset managers.
- However, the interviews revealed that external managers must work harder to build trust: delivering alpha; demonstrating knowledge of local regulations; and providing valuable investment insight.

Theme 5 - Investment risk exposed

The modernisation of regulatory regimes is leading to greater transparency on risk. This impacts both the profit and loss account and balance sheet of insurance companies. This creates the need for closer collaboration between insurance experts and their investment colleagues in order to arrive at the optimum investment strategy.

- The challenge increases when there is a disconnect between accounting and solvency standards, as both transition from book-based to market-based regimes.
- 89% of insurers surveyed indicated the need for closer collaboration between actuarial and investment teams.

Survey Findings - Key Statistics

55% cited asset-liability mismatch as an issue

76% expect the trend to increase alternative assets to drive more use of external managers

61% cited hedging costs as a major barrier to increasing international allocations

78% intend to increase exposure to infrastructure

64% are looking to add to real estate

78% intend to increase international investments

75% intend to increase private equity

89% indicated the need for closer collaboration between actuarial and investment teams

Source: findings of Standard Life Investments Asia Pacific Insurance Survey 2017

Survey Findings - Key Quotes

"We allocate up to 50% to Japanese Government Bonds, so it has been a struggle to meet target returns and guarantees"
Japanese life insurer

"The low return environment has reduced the attractiveness of guarantees and is forcing a shift to investment-linked products"
Taiwanese life insurer

"Meeting existing guarantees is not an issue, but pricing new guarantees competitively will be an issue going forward"
Mainland Chinese life insurer

"Insurers are aggressively offering shorter duration, high return products"
Mainland Chinese life insurer

"The limited supply of longer dated Japanese Government Bonds is driving the shift into longer duration infrastructure debt investments"
Japanese life insurer

"We want to increase alternative allocations but lack capabilities to manage alternative assets in-house at the moment"
South Korean insurer

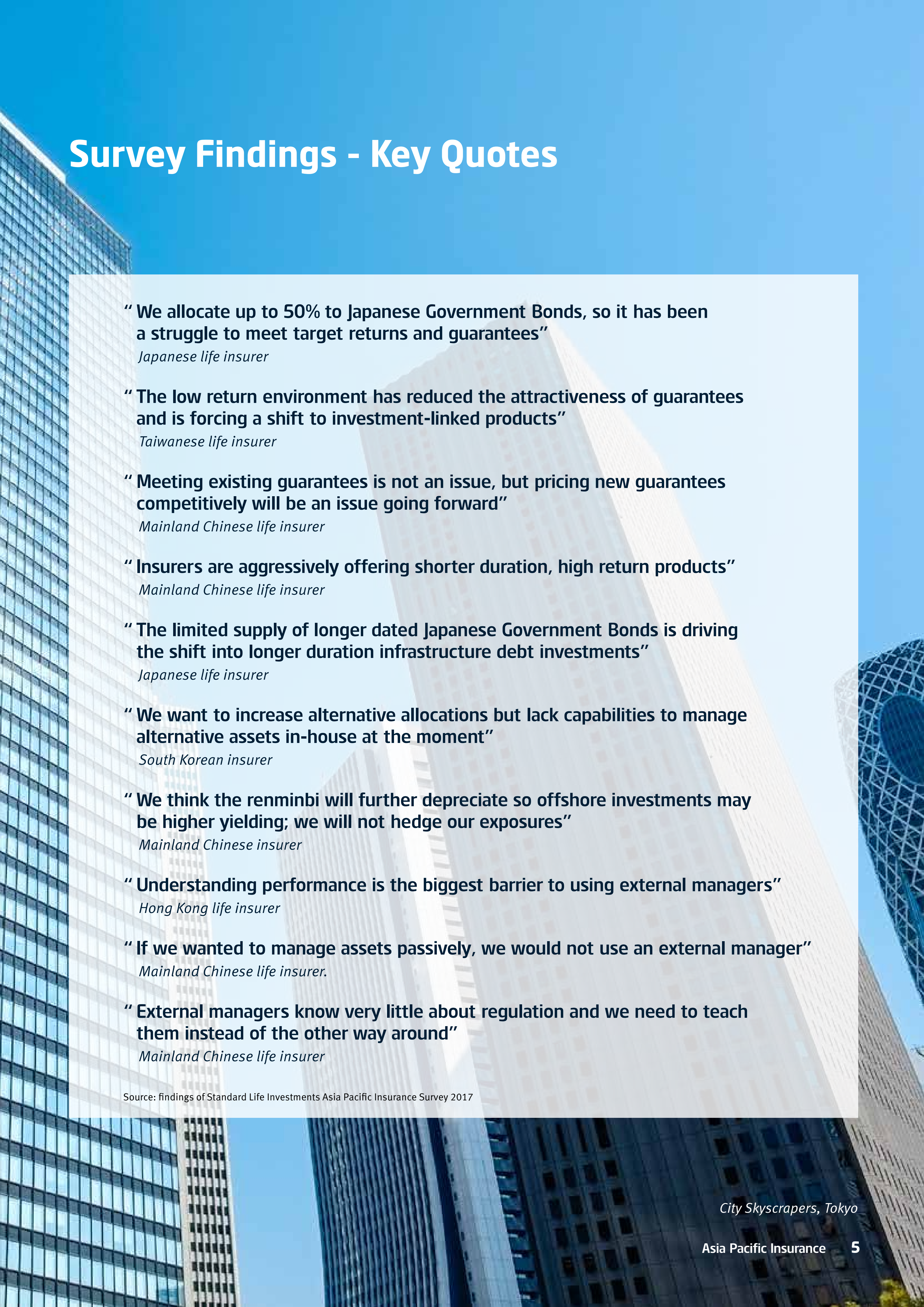
"We think the renminbi will further depreciate so offshore investments may be higher yielding; we will not hedge our exposures"
Mainland Chinese insurer

"Understanding performance is the biggest barrier to using external managers"
Hong Kong life insurer

"If we wanted to manage assets passively, we would not use an external manager"
Mainland Chinese life insurer.

"External managers know very little about regulation and we need to teach them instead of the other way around"
Mainland Chinese life insurer

Source: findings of Standard Life Investments Asia Pacific Insurance Survey 2017



City Skyscrapers, Tokyo

Conclusions

Our research collates the views of the participants we surveyed across the Asia Pacific insurance industry into five themes. We see these themes as one story that will shape the industry over the coming years.

Five themes, one story

Insurers face an increasingly difficult investment challenge. Lower bond and cash returns make it difficult to generate the returns needed to deliver guaranteed returns. At the same time, regulatory change is exposing the asset-liability mismatches in current investment strategies (theme one). This is leading insurers to seek both higher returns and longer maturity assets in alternative assets and global markets (themes two and three). External asset managers can help fill skill gaps in these areas but there are barriers to overcome, both real and perceived (theme four). Regulations are being modernised across the world, bringing greater transparency on risk. This has investment implications and is driving a need for greater collaboration between actuarial and investment teams, both internally and externally (theme five). This is driving a fundamental change in the way that investment decisions are made.

Industry in transformation

Greater transparency on risk has implications for both the investment approach and the business model of insurers. Investment portfolios need to be more outcome-oriented, with a greater emphasis on controlling risks. From a business perspective, this is leading to a shift from guaranteed return products to investment-linked savings. This leaves us with three challenges to the industry that are implicit in the survey.

Reality gap on return gap?

In our interviews, investors recognise the challenge of generating returns in a world of low bond yields. This is not only because starting yields are lower but also because returns have been boosted by an upward rerating of both equity and bond markets. This should not be extrapolated into future returns. However, survey respondents cited expected returns that are broadly in line with historic returns. Competitive pressures mean that guaranteed returns have not been reduced as fast as bond yields. This increases the investment challenge – and increases the chance that returns will fall short.

Solving the outsourcing puzzle?

Insurers are open to exploiting investment opportunities in alternative assets and global equities. They may lack the internal expertise to do so and therefore employ external managers. However, they can be resistant to increasing the use of external managers. This contrasts with our European survey, where the asset allocation decision was the same but there was an acceptance that this meant putting more assets with external managers. Some insurers indicated an appetite to build an in-house capability, but this takes time and money. In particular, investing in private equity, property and infrastructure requires specialist skills even to access the investments, let alone add value. The shape of the industry will depend on whether insurers decide to outsource more, build their own teams or forego the opportunities in alternatives and global assets.

The missing link?

The survey highlights the need for greater collaboration between investment and insurance teams. It also highlights the need for greater collaboration between internal and external managers in order to build trust. In particular, external managers must demonstrate an understanding of domestic market requirements. To us, this says that the external asset managers most likely to succeed in addressing the issues raised by the insurers in this survey are those with in-house insurance expertise of their own. They genuinely understand the practical intricacies of insurance investment in these markets. By linking investors and actuaries, internally and externally, insurers are more likely to arrive at the right solution to their investment challenges.

If you would like to find out more, please visit www.standardlifeinvestments.com where you will find contact details for your location.

Visit us online

standardlifeinvestments.com

This material is for informational purposes only. This should not be relied upon as a forecast, research or investment advice. It does not constitute an offer, or solicitation of an offer, to sell or buy any securities or an endorsement with respect to any investment vehicle. The opinions expressed are those of Standard Life Investments and are subject to change at any time due to changes in market or economic conditions.

Central Hong Kong

INVBGEN_16_1825_Asia_Pacific_Insurance_Survey_8 pages_TCM 0617