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Markets' new paradigm: which strategies for insurers?

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The combination of stricter regulatory requirements, a volatile market and rising interest rates will necessarily have an impact on insurers' investment strategies. Although there is no simple answer to these market conditions, Rémi Lamaud, solution expert, insurance management & ALM solutions at Ostrum AM, explains how portfolio allocation has to reviewed to respond to each insurer's accounting objectives, asset-liability backing and socially responsible ESG investments.

Which key regulatory changes affecting insurers do asset managers need to adapt to?

Insurers' accounting standards have changed significantly over the past few years. They are shifting away from using historical values for equities and amortised costs for bonds, and moving increasingly towards mark-to-market pricing. The move began with Solvency 2 and has been furthered by the IFRS 9 international accounting standard, which succeeded IAS 39. This trend has sharply increased balance sheet sensitivity to market shocks, which now implies taking the embedded volatility of assets into account. Beyond this major shift, it is also important to understand that insurers are facing a multi-referential environment, including French accounting norms, Solvency 2 regulations and the international IFRS 9 accounting standards.

What is the impact on asset management?

We have entered an even more multidimensional asset management scenario, which involves reconciling our view on the financial markets with regulatory requirements. Solvency 2 imposes more stringent regulatory capital requirements upon insurers when they include riskier assets in their allocations, while international standards impose greater volatility in financial statements and shareholders' equity. Investment decisions must therefore take these three types of objectives into account. In response, we have built our own in-house PASS insurance investment platform, which enables us to manage these different aspects within a single proprietary system.

Has this complexity turned insurers away from the more volatile markets like equities?

It has meant that technical investment expertise has had to be fine-tuned, by drawing on high-performance analysis and simulation tools. Investment solutions are becoming increasingly complex and need to be adapted to insurers' profiles and objectives. There are no standard model portfolios, as life insurers will not have the same investment horizon restraints as property & casualty insurers for example.
At Ostrum AM, we have developed close relations with our insurance clients, in order to integrate their specific accounting, financial, regulatory and ESG objectives, and also to turn these factors into investment opportunities. Although insurers have not shunned the equity markets, chiefly due to their high returns and dividend yields, it is true that with these accounting changes, market volatility has led to asset reallocation within portfolios.

What solutions can you provide against equity market volatility and rising interest rates?

We are observing the sharp uptick in interest rates very closely. We are monitoring the pace and extent of the increase, compared to the inflation rate, and analysing different market scenarios. We are then putting hedging or protection strategies in place, based on whether our institutional investors prioritise accounting, regulatory or financial objectives. We are also proposing specific solutions aiming to limit portfolio volatility and increase their resilience against potential market shocks for example. These factors enable insurers to modify their equity or fixed-income weightings and their allocations within each of these asset classes.

What further changes could also impact insurance portfolio management strategies?

The most important issue is the joint implementation of IFRS 9 and IFRS 17 standards next year, which will lead to the application of new asset and liability accounting methods. One of the main points involves most assets having to be marked to market, including equities and non-vanilla bonds. The other key change covers allocation and investment processes, taking SRI factors into account and the associated multiple referential standards. Lastly, under Solvency 2, the symmetric adjustment mechanism will be widened, meaning that regulatory shocks will have an even greater impact on equities. We are already assessing the consequences of all of these factors with insurers.

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Additional notes

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