



# FUTURE INVEST RETURNS, IMPACT

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IW&I Financial Mutuals and Insurance Investment Conference  
March 2018



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- Investment returns – low forever?
- Impact for consumers / firms
- Holistic investment strategy
- Alternatives



# INVESTMENT RETURNS AT PRESENT



# What has happened since 2013?

Asset Class	2013	2014	2015	2016	2017	Cumulative
Gilts	-3.94%	13.86%	0.57%	10.09%	1.83%	23.30%
Corporate Bonds	0.54%	13.45%	0.07%	13.32%	4.53%	35.21%
UK Equities	20.80%	1.20%	1.00%	16.80%	13.10%	63.11%
World Ex-UK Equities	25.70%	13.18%	6.11%	29.78%	12.46%	120.33%
Property	23.80%	21.30%	12.10%	-8.50%	12.70%	73.59%
Infrastructure	18.50%	20.10%	-10.70%	13.10%	16.20%	67.03%

Appears a good solid investment return for all assets over the last 5 years

Ex UK Equities doubled their money



# Mix of assets

Asset Mixes	Average	Return
Gilts	35.9%	8.38%
Corporate Bonds	24.6%	8.66%
UK Equities	19.3%	12.21%
World Ex-UK Equities	10.6%	12.71%
Property	7.1%	5.22%
Infrastructure	0.0%	0.00%
Deposits	2.5%	0.00%
Total	100.0%	47.17%
Average		8.03%

Heavy bond concentration with our average client but still had 37% in risk assets. Achieved 8% on average each year



# Current returns

Gilt indices	Redemption Yield
5 to 10 years	1.32%
10 to 15 years	1.67%
15 to 20 years	1.48%
20 to 25 years	1.85%
25 years plus	1.71%

Part of the historic return in gilts has been eating away at future returns within the redemption yield

All below 2% nominal. RPI is expected to be 3% plus



# Other assets neutral assumptions

Asset type	Return of asset type	Mix
Gilts from above	1.67%	36%
Corporates + 1%	2.67%	25%
Properties + 2.5% after costs	4.17%	7%
Equities +3.5%	5.17%	30%
Cash	0.4%	2%
Average	3.12%	100%



# Expectation by 2 investment managers

Asset type	Expected return pa
Gilt	About +0.5%
Corporate	About +1.75%
Equity UK	About +7.00%
Equity Ex UK	About +7.00%
Property	About +5.00%
Cash	About +1.25%

Equities will return more but be far more volatile than other assets





# Charges on savings – source - KIDS

	RHP	Average	Max	Min
Regular ISA	5	2.16%	3.06%	1.39%
Regular ISA	10	1.83%	2.12%	1.67%
Single ISA	5	1.72%	2.19%	1.39%
Single ISA	10	1.95%	2.41%	1.68%
10 Year TESP (With Life)	10	3.60%	5.80%	2.34%
Bond	5	1.00%	1.59%	0.41%
Bond	10	2.35%	5.20%	1.41%

We sampled 10 friendly societies' web sites to arrive at the RIY quoted on the KIDs documents



# IMPACT ON CONSUMERS AND FIRMS



# For consumers.....

- Gross return of 3.12% less these RIYs
- Nil, just positive or even negative
- Is it worthwhile?
- Cost of guarantee made up of safe investments plus option cost for equity/property



# For firms..... With- profits

- Bonus rates limited due to difference between return and RIY
- More required in safe assets?
- Less loss absorbency
- Less flexibility.....



# Options

- Reduce guarantees?
- Change investment mix to take more risk
- Move to unit linked
- Allow customer to choose level of guarantee?



# Customer

- What do they want?
- Low risk but reasonable returns
- Is this possible to give



# For firms – GI long tail

- Rely on investment returns to balance loss ratios
- Negative real returns and Periodic Payment Orders
- Ogden rates



# For firms - cash plans

- Loss ratio being uncovered
- Earnings for charities from surplus assets being reduced





# Options

- Increase premium rates
- Reduce exposure and coverage
- Reduce payouts to charity



# What can change all this?

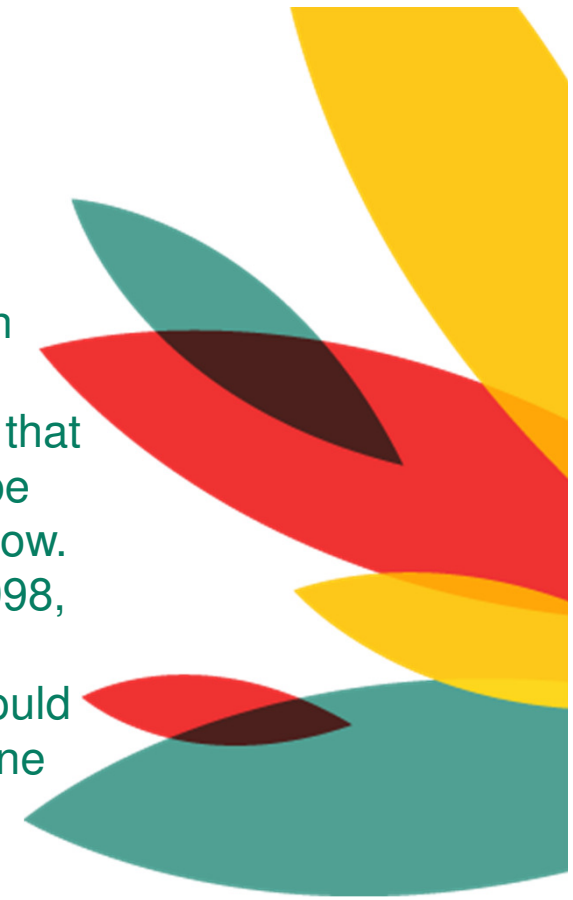
- Return of inflation
- Fall in gilt values and increase in RF rates and gilt returns
- Fall in equity values but increased returns due to inflation
- Rents start inflating



# History of 10 year gilt yields



When yields move they can move quickly. No guarantee that move up will be smooth and slow. Note 1993, 1998, 1999. Fall in early 90s. Could reach 4% in one year, certainly 2-3?



# RISK APPETITE AND STRATEGY



# Why is risk appetite so important?

- Aims of why you are investing?
- Formulation of risk appetite
- Investment freedom, variability of payouts
- Relationship SCR and own funds
- Loss absorbency
- Risk appetite / PPFM / MAP / Documentation



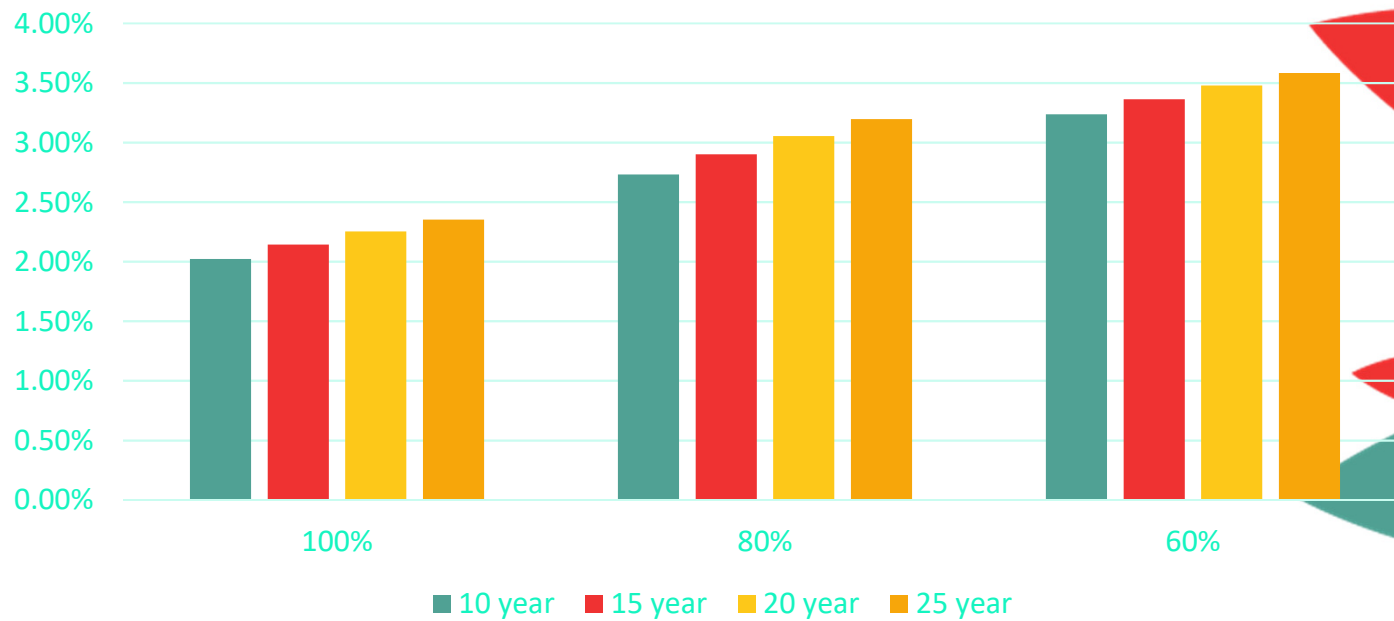
# Aims of investment- Example

## 1- WPF Bond/ISA

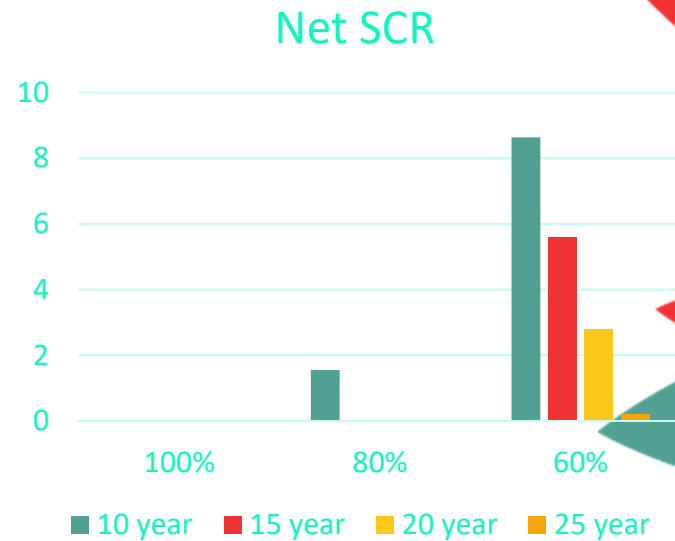
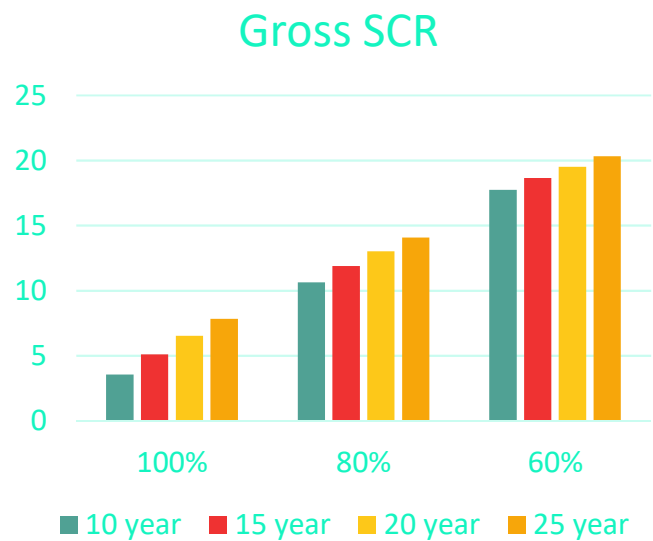


# Returns to policyholder

First year expected return



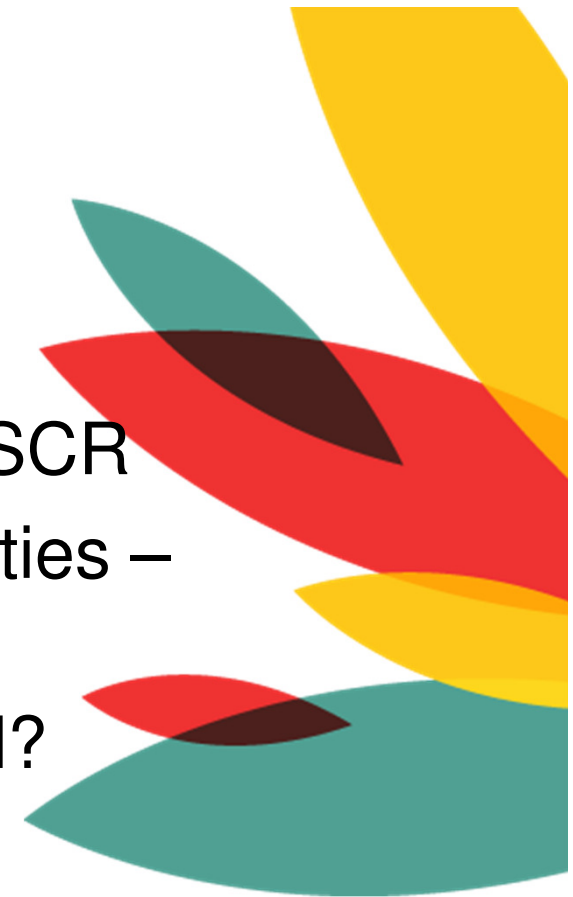
# Impact on SCR





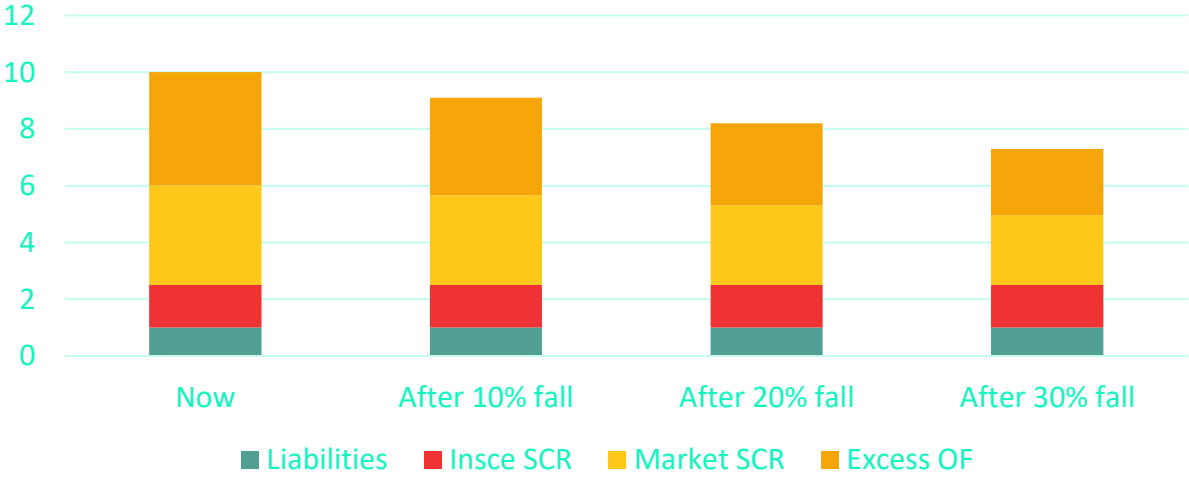
# Cash plan example

- £10 mn fund
- £1 mn liabilities plus £1.5 mn health SCR
- Aim to provide moneys for local charities – over the long term
- Where should the money be invested?
- What will generate best long term returns?



# Assume 1mn safe, 9mn equities

Effect of fall in equity on balance sheet



# Investment return though....

- If 100% safe, could be 0.5%
- If 90% equity, could expect 4.3%



# Risk appetite, PPFM, MAP – with-profits

- The PPFM and marketing literature sets policyholder expectations
- This can be converted into a MAP
- This can lead to loss absorbency
- This can give the board freedom for greater risk appetite
- Risk appetite should also reflect policyholders' appetite for risk



# Other inputs

- Product literature
  - Terms and conditions
  - Key Information Document/ KF
  - Guarantees implied in previous bonus notices
- Statements in accounts?



# Who needs to be involved?

- Risk
- Actuarial
- Investment – of course
- Board or board level committee



# Mitigators for loss

- On top of loss absorbency or capital
- Derivatives
- Trigger points
- Clear freedoms given to manage portfolio
- Need to know what you are invested in at all times



Alternative investments

# GETTING MORE BANG FOR BUCK





# Pseudo Bonds

- Equity release
  - Market, illiquid, good returns
- Bonds on infrastructure and other private deals
  - Effort in setting up structures, care on Solvency II



# Finally

- Likely to see move to more diversification of risk
- Likely to see some alternatives being used
- Success depends on close integration of key specialisms



# Want more information?

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