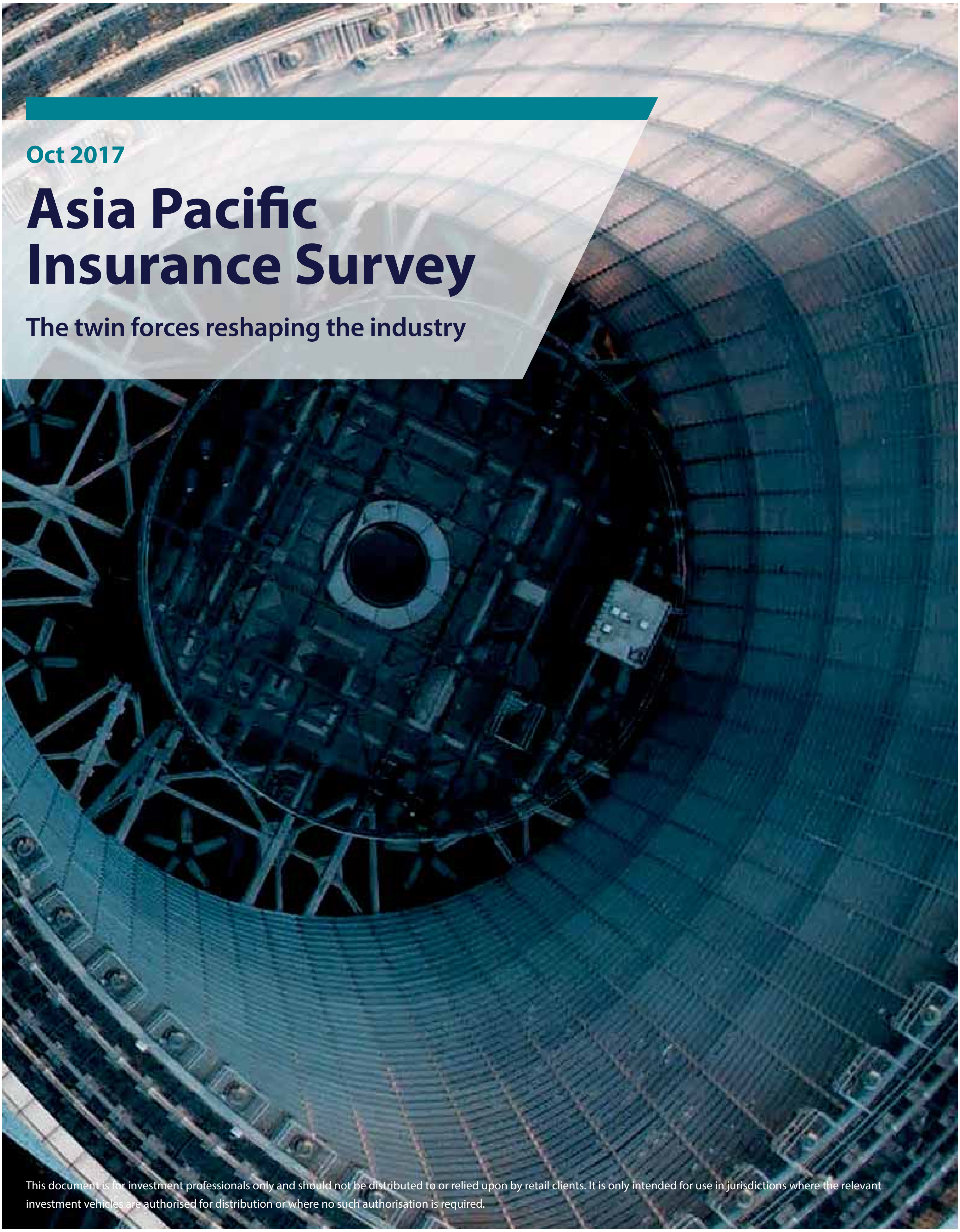
Oct 2017

Asia Pacific Insurance Survey

The twin forces reshaping the industry



Contents

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 its research on the European insurance industry in the lead up to the arrival of Solvency II, Standard Life Investments turned the lens to Asia Pacific. In 2016, it commissioned in-depth research to identify the latest trends impacting Asia Pacific insurance companies and the implications for their investment strategies. This survey identifies the pressures facing traditional business models and analyse the investment implications.

Dr Bruce Porteous, FFA, FIAI
Investment Director
Insurance Solutions

Standard Life Investments' 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 the 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.

Five themes, one story

Asia Pacific insurers face an increasingly difficult investment challenge. Lower bond and cash returns make it difficult to generate the investment returns needed to deliver guaranteed returns to policy holders. At the same time, regulatory change is exposing the asset-liability mismatches in current investment strategies. These five themes encapsulate the key challenges the industry faces. Together they are driving a fundamental change in the way that investment decisions are made. This poses new challenges for both insurance companies and the managers of their assets.

Survey Findings

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

"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

Introduction

Back in 2016, Standard Life Investments commissioned a survey to identify and understand the long-term impacts of historically low interest rates and the modernisation of regulatory regimes on insurers in Asia Pacific. NMG, an independent global research consultancy, conducted the fieldwork and analysis that form the basis of this report.

The research was conducted in six markets across Asia Pacific, selected to ensure coverage both in terms of market size and in terms of markets at different stages of industry maturity.

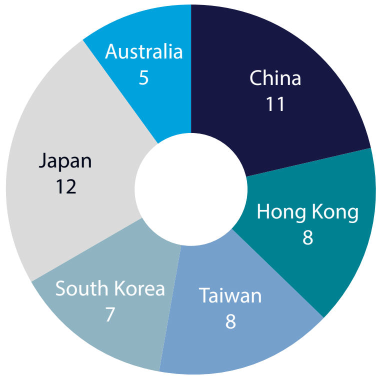
NMG conducted one hour, face-to-face interviews with 51 senior investment professionals during Q1 2017.

Research population

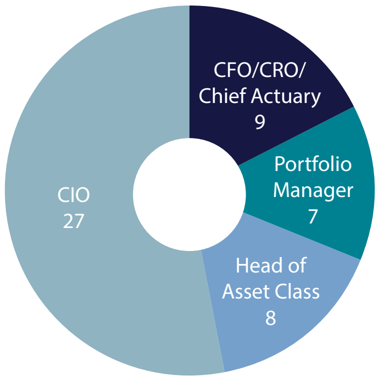
The research focused on investment professionals managing balance sheet assets that back guaranteed savings products and other insurance policies. Respondents interviewed represented over $4 trillion of assets under management, representing an estimated 60% of total insurance assets within the region. Coverage included both domestic and global firms and while it was skewed towards the larger insurers in each market, some smaller insurers were included.

Methodology & coverage

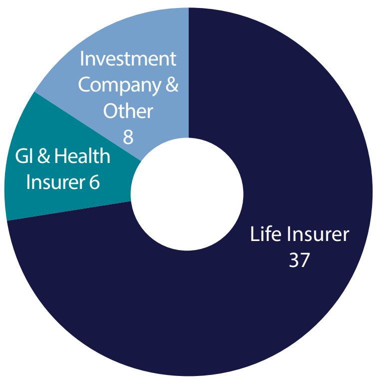
Country/Market



Roles



Company type



Q1: Which of the following best describes your roles?
Total sample = 51

Source: Standard Life Investments Asia Pacific Insurance Survey 2017

Theme 1:

Mind the gap?

The health of the Asia Pacific insurance industry is mixed. Guaranteed savings products represent half of the business written in the six markets surveyed. The investment returns generated to back these guarantees are not always sufficient to fund the guaranteed rates. The research found that insurers in Japan, South Korea and Taiwan are not earning enough to meet the promises they have made to end-customers.

- Guaranteed products represent 51% of the asset mix of insurers surveyed, compared to 39% of European insurers surveyed in 2015.
- 55% of insurers surveyed cited asset-liability mismatch as an issue.

The outlook for returns and the implications for providers of guaranteed savings products provide the starting point for the survey. Expected returns provided by survey participants do not point towards a significant future problem – but interviews point to risks in these expectations. We identify which markets face an immediate issue, highlight those participants who voiced concerns on future returns, and look at how this is shaping the industry. At the heart of this theme are the competing objectives of insurers, distributors and their customers.

Immediate return gaps

Many insurers in Japan, South Korea and Taiwan are currently experiencing return deficits in their guaranteed savings products.

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

The gaps between current and target returns are modest (see figure 2), but the long term nature of these products means these small gaps can generate big losses. These insurers have the highest allocations to domestic sovereign fixed income markets. The current low yield on these investments means expected return forecasts in line with historic returns are likely to prove too optimistic.

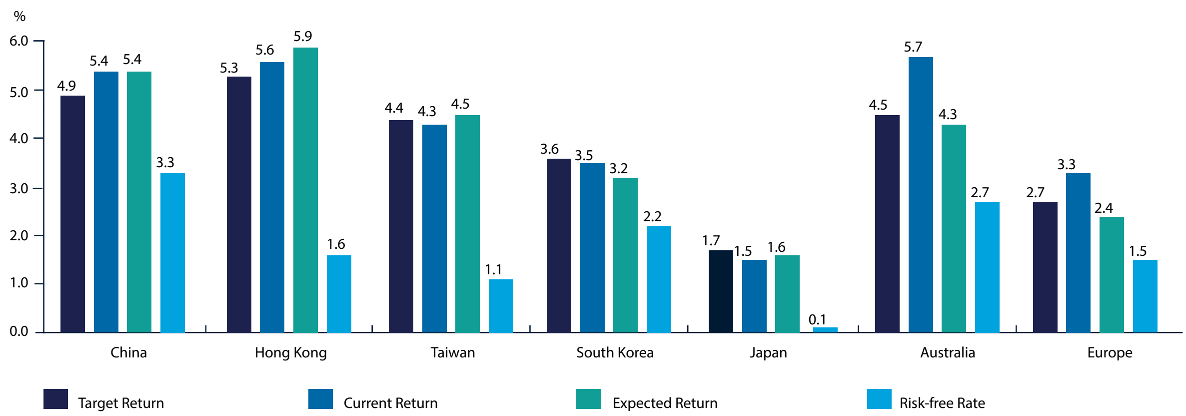
Future return gaps?

The gap between the expected return and risk-free rate provides a significant investment challenge. In every market surveyed, the gap is greater than we found in the 2015 survey of European insurers. Competitive pressures mean that guaranteed rates have been slow to respond to the fall in risk-free rates. This increases the risk of future shortfalls.

In addition, there is clear risk of a future return gap in China and Hong Kong due to the need to eliminate a mismatch between assets and liabilities. This will prevent them buying the higher yielding, longer dated assets that have delivered returns in excess of the guaranteed rates on the large volumes of shorter duration business they have been writing recently. Despite these concerns, expected future returns are in excess of target returns in China, Hong Kong and Taiwan.

Figure 2

Target, current and expected returns for guaranteed savings products



Source: Standard Life Investments European Insurance Survey 2015; Standard Life Investments Asia Pacific Insurance Survey 2017; Investing.com, 1 March 2017

Asset-liability mismatches

Asia Pacific insurers told us that they face asset-liability mismatches in both directions: long duration liabilities backed by shorter dated assets and vice versa. Insurers across the region have always had to cope with the limited universe of local long-dated bonds with which to match longer dated liabilities. Short-term assets backing long-term liabilities in Japan, Korea and Taiwan may contribute to future return gaps due to reinvestment risk. More recently, mainland Chinese insurers have generated above-target returns through investments in illiquid loans, often linked to infrastructure and government finance, especially on shorter duration, high guaranteed return business. Hong Kong insurers also back shorter duration liabilities using long term assets. These mismatches represent risk on a number of dimensions: liquidity risk, credit risk and profit risk (which is set to increase, as discussed in theme five).

Shift in product mix: from guaranteed savings to investment-linked

Insurers in a number of markets are actively pursuing a shift away from guaranteed savings products towards investment-linked products. This shift is being driven by the low return environment. Some insurers surveyed feel they are no longer able to offer attractive guaranteed returns. 44% of respondents said they are struggling to meet investment guarantees to existing customers and price new guaranteed business at competitive prices, while 38% disagreed (with the balance undecided).

Customers seeking higher returns are increasingly bearing the investment risk instead of the insurer. Distributors (who are typically remunerated on commissions) and insurers can illustrate attractive long term returns for investment-linked products that may, in practice, prove difficult to achieve in the future.

Currently around half of all assets of insurers in the survey back guaranteed savings products, approximately $2 trillion across the region. This proportion varies from 87% in China and 62% in Japan down to 13% in Australia, where these are legacy products (see figure 3).

The low return environment has reduced the attractiveness of guarantees and is forcing a shift to investment linked products.

Taiwanese life insurer

Despite this shift, guaranteed savings products are still expected to grow across all markets except Australia. Taiwanese insurers surveyed, for example, expect sales of investment-linked products to grow at 6% per annum compared to 2% for guaranteed savings products over the next three to five years (see figure 4). China stands out from the rest of the region, as discussed in the next section.

China: challenges of a high-growth market

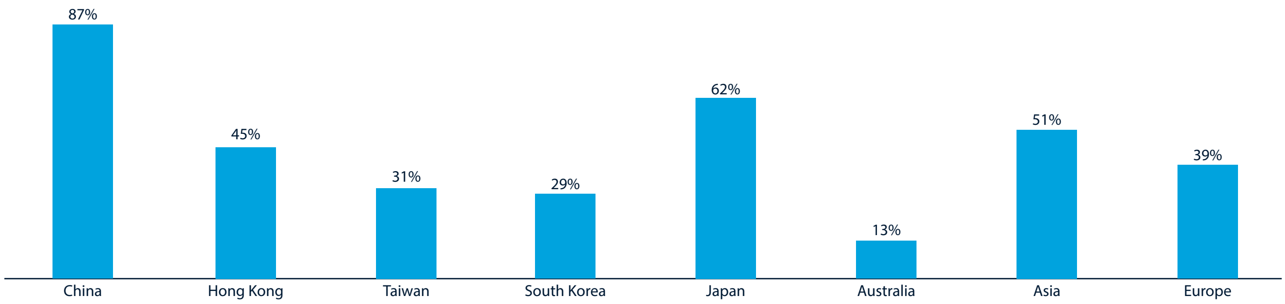
China faces unique challenges. The industry is growing rapidly, led by guaranteed products. Strong growth has led to strong competition, resulting in escalating guarantees on new policies. There is a lack of higher-yielding assets to back these assets in the domestic market and regulatory restrictions on investing overseas. Insurers have handled this conundrum by investing in longer-duration illiquid loans, backing infrastructure projects or local government ventures, and other illiquid assets like real estate. These have delivered the required returns to date, but represent a significant duration and liquidity mismatch between assets and liabilities.

Australia: less stress

Guaranteed products are no longer offered and the legacy book is not causing immediate problems. The low return environment poses fewer pressures for Australian insurers than their regional peers.

Figure 3

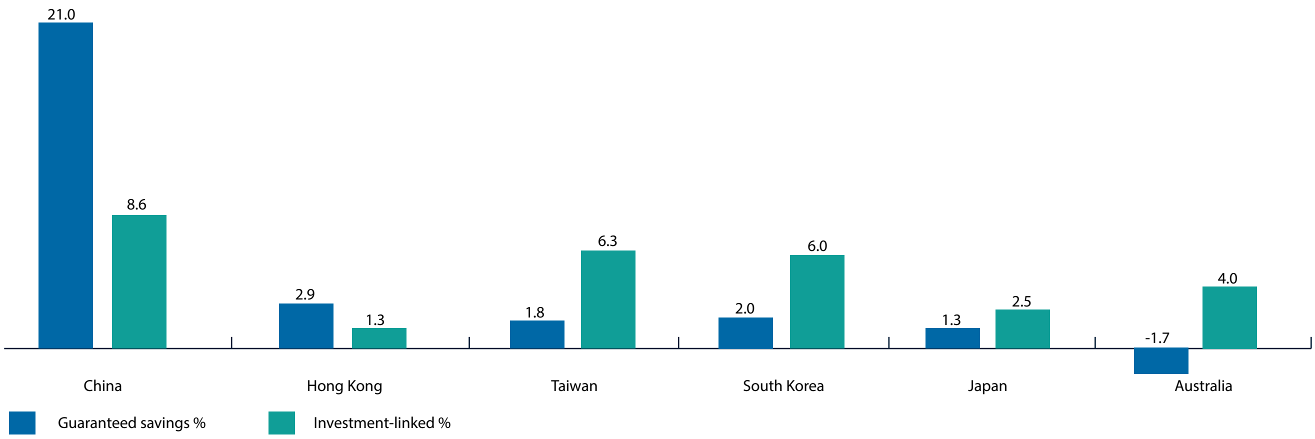
Guaranteed savings products as % of current product mix



Source: Standard Life Investments European Insurance Survey 2015;
Standard Life Investments Asia Pacific Insurance Survey 2017

Figure 4

Expected per annum sales growth in the next three years



Source:Standard Life Investments Asia Pacific Insurance Survey 2017

Comparison of Asia Pacific 2017 and Europe 2015 Insurance Surveys

Europe	Insight
Theme 1 Increasingly, European insurers can no longer generate sufficient returns to meet guaranteed rates to policyholders	The issues are broadly the same, with some Asia Pacific markets, notably China and Hong Kong, at an earlier stage in the crystallisation (and perhaps realisation) of this issue.
Theme 5 Insurer business strategies and profitability are under pressure, with a structural shift away from guaranteed savings to unit-linked structures.	The direction of travel is very much the same in both regions. However, European and Australian insurers are further down the journey of transforming product models away from guaranteed products to investment-linked propositions.

Meeting existing guarantees is not an issue, but pricing new guarantees competitively will be an issue going forward.

Mainland Chinese life insurer

Theme 2:

The dual role of alternatives

In response to the investment challenges set out in theme one, insurers are adapting their asset allocation strategies. Insurers intend to increase allocations to alternative assets and global equities (see theme three), reducing exposure to domestic fixed income securities (see figure 5). The survey revealed both the drivers behind these intentions and the barriers they will need to overcome in implementing this strategy.

- Allocations to cash, bank deposits and fixed income securities make up almost 71% of total assets invested.
- 78% of insurers intend to increase exposure to infrastructure, 75% seek to increase private equity and 64% are looking to add to real estate..

Figure 5

Proportion of insurers expecting future allocation to increase minus proportion of insurers expecting future allocation to decrease for each asset class

	Domestic Sovereign Fixed Income (%)	Domestic Corporate Fixed Income (%)	Overseas Sovereign Fixed Income (%)	Developed Investment-Grade (%)	EM Corporate Fixed Income (%)	Regional Equity (%)	Global Equity (%)	Cash (%)	Infrastructure (%)	Real Estate (%)	Private Equity (%)
Asia Pacific	**-34**	**-19**	**41**	40	-50	16	**27**	-8	**78**	**64**	**75**
by Country											
China	-33	-33	0	0	0	36	-33	-17	100	67	100
Hong Kong	0	-25	0	25	-100	33	0	0	75	67	80
Taiwan	0	-33	33	25	0	20	60	0	50	33	50
South Korea	-100	-100	100	0	0	0	0	0	100	100	100
Japan	-67	50	50	67	0	-50	50	0	100	**0**	50
Australia	-40	20	100	100	0	-14	100	0	50	50	0

Source: Standard Life Investments Asia Pacific Insurance Survey 2017

In search of higher returns

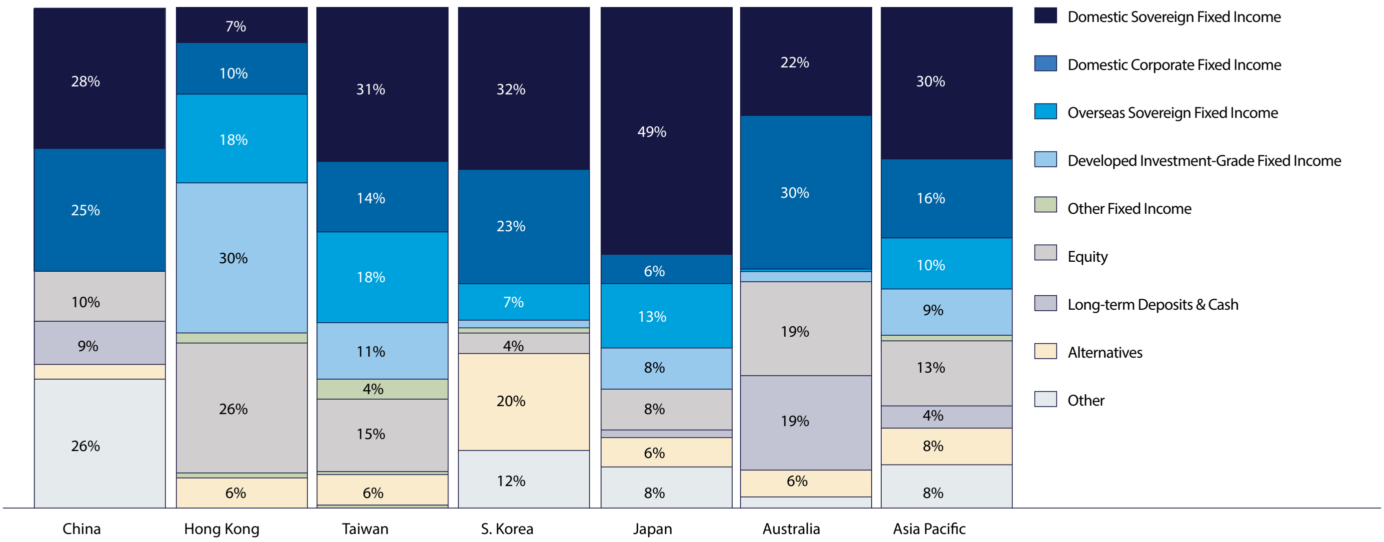
Allocations to cash, bank deposits and fixed income securities make up almost 71% of total assets invested across Asia Pacific insurers (see figure 6). The fall in yields on fixed income securities has driven insurers to consider increasing allocations to equities and alternative assets in search of higher returns.

Current allocations to alternative assets - real estate, infrastructure, private equity and hedge funds - stand at 8%. This compares to 12% for European insurers surveyed in 2015. However, the 8% figure doubles to 16% once investments categorised as 'other' are included. Much of this allocation is made up of alternative loan investments, with significant allocations in China, South Korea and Japan.

Within my alternatives portfolio, private equity will be the area of fastest growth in the next three to five years.

Mainland Chinese life insurer

Figure 6
Current asset allocation



Source: Standard Life Investments Asia Pacific Insurance Survey 2017

Different alternative asset classes bring different benefits, but in all cases investors expect higher returns through the harvesting of illiquidity premiums. For example, private equity cannot be used to match liabilities, but despite this there is growing demand for this investment strategy.

"Insurers are aggressively offering shorter duration, high return products."

Mainland Chinese life insurer

In search of longer dated assets

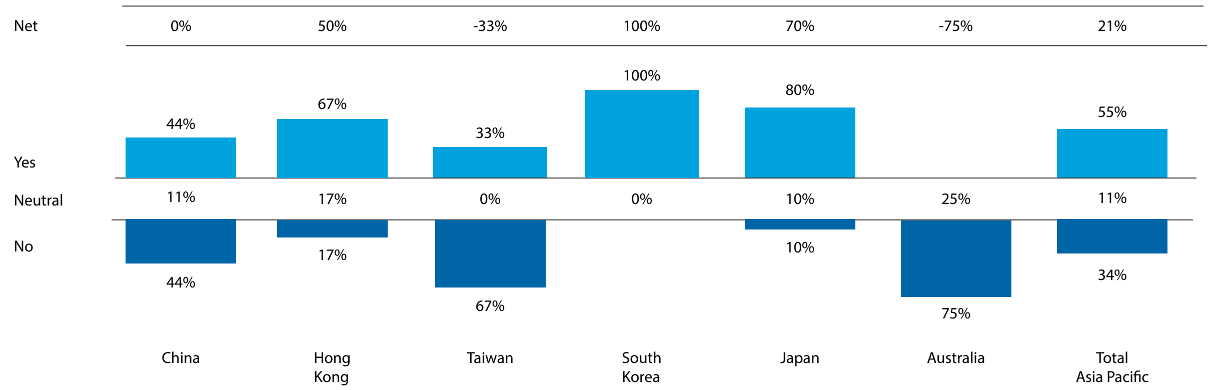
A number of the insurers surveyed cited asset-liability mismatches as an issue, as discussed in theme one. For this reason, infrastructure debt is an area of particular interest as it offers both hi*gher yields a*nd longer duration assets to better match insurers' liabilities.

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

Japanese life insurer

Figure 7

Proportion of insurers citing asset-liability mismatch as an issue



Note: Sample size by market: China 9, Hong Kong 6, Taiwan 6, S. Korea 3, Japan 10, Australia 4,
Q32b. To what extent do you agree with the following statements: asset-liability mismatch will continue to be a problem in the next three to five years.

Source: Standard Life Investments Asia Pacific Insurance Survey 2017

Solvency regimes less of a barrier than in Europe

In general, the solvency regimes across Asia Pacific require lighter capital requirements when investing in alternative assets than the Solvency II regime in Europe. For example, real estate investment is supported by solvency regimes such as the China Risk Oriented Solvency System (C-ROSS), which attaches lower capital charges to real estate than Solvency II. While the direction of travel for these regimes as they are modernised is in the direction of the European regulations, this lighter capital treatment may not entirely disappear. In any case, insurers are often willing to seek higher returns from alternatives even if they are required to bear higher capital charges.

Lack of in-house expertise

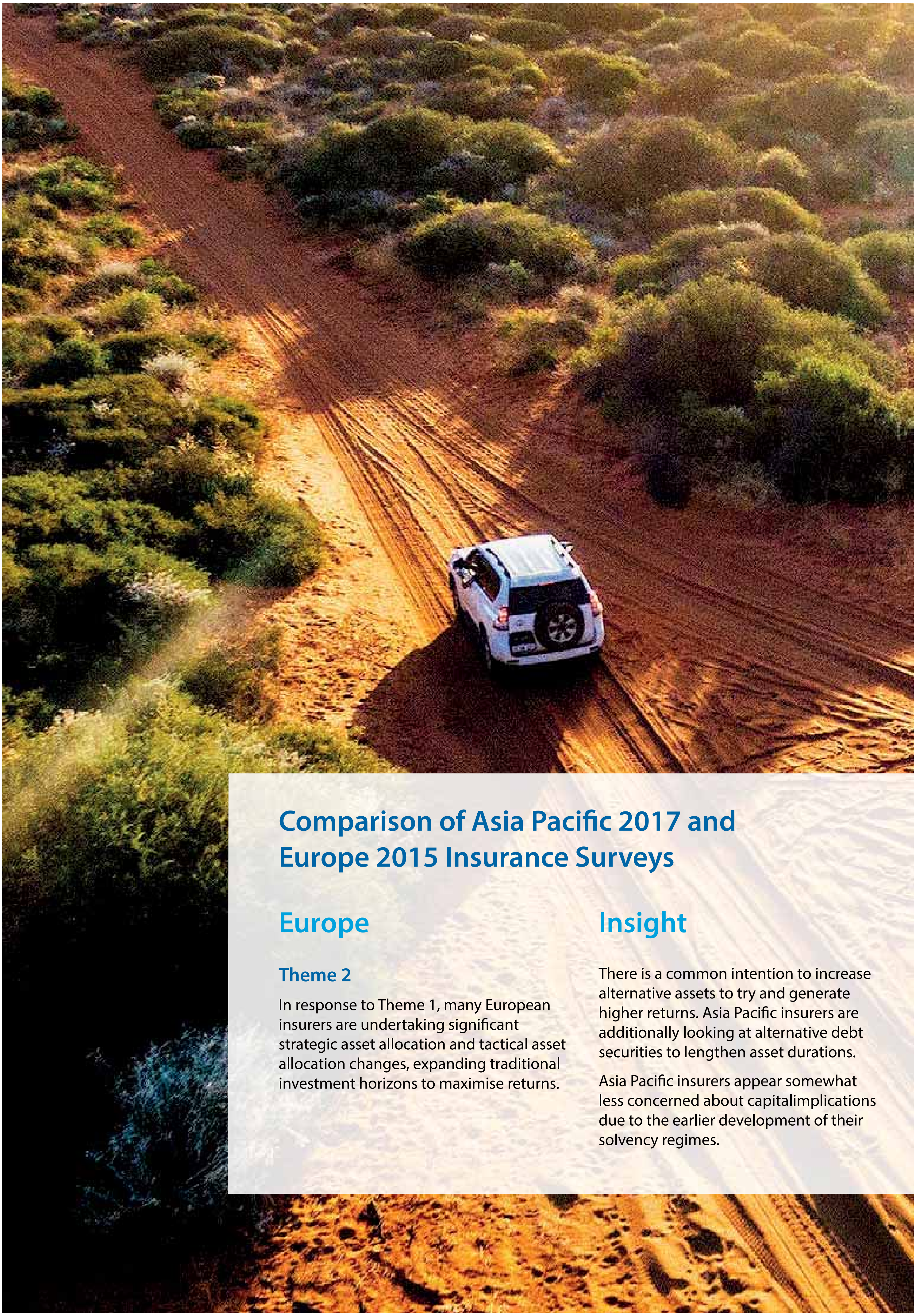
The survey found that a lack of in-house expertise was a major challenge preventing higher allocations to alternatives. This was notably the case in South Korea. Some insurers in other markets cited relatively strong internal or group-wide investment capabilities in these areas. This is an issue we will discuss in depth in theme four.

Japan: real estate scars yet to heal, one generation on

It is notable that none of the Japanese insurers surveyed intend to increase exposure to real estate, in marked contrast to their regional peers (see figure 5). The survey covers an estimated 90% of all insurance assets under management in Japan, making this a particularly striking statistic. Japanese insurers suffered significant losses in domestic and US real estate markets in the late 1980s and through the 1990s. The survey found that, as a result, they remain cautious on this asset class, even one generation on. (Interestingly, in contrast to the survey findings, our own subsequent conversations with Japanese insurance clients point to a growing interest in reallocating to real estate across both debt and equity. In particular, we are seeing interest in European real estate given the high costs of hedging US dollar assets.)

We want to increase alternative allocations but lack capabilities to manage alternative assets in-house at the moment.

South Korean insurer



Comparison of Asia Pacific 2017 and Europe 2015 Insurance Surveys

Europe

Theme 2

In response to Theme 1, many European insurers are undertaking significant strategic asset allocation and tactical asset allocation changes, expanding traditional investment horizons to maximise returns.

Insight

There is a common intention to increase alternative assets to try and generate higher returns. Asia Pacific insurers are additionally looking at alternative debt securities to lengthen asset durations.

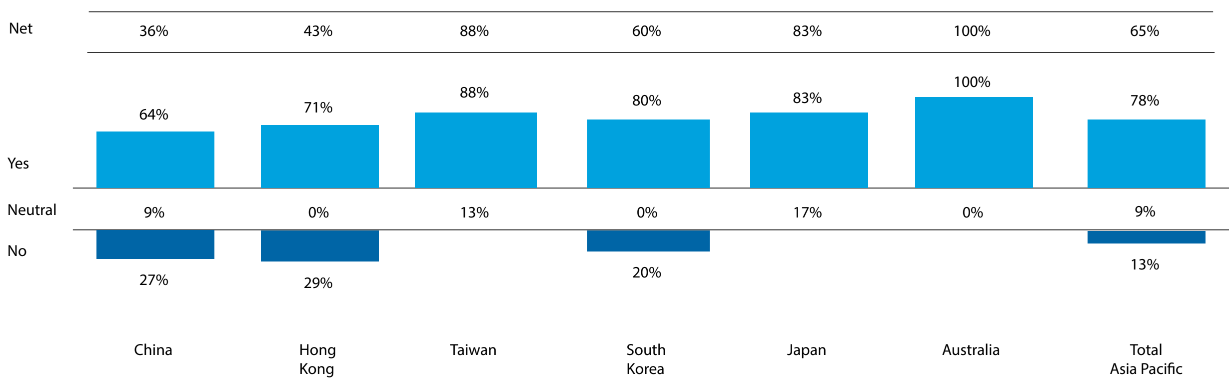
Asia Pacific insurers appear somewhat less concerned about capitalimplications due to the earlier development of their solvency regimes.

Theme 3:
Global opportunities, local challenges

Insurers intend to increase international allocations in response to the investment challenges set out in theme one (see figure 8). The drivers are the search for higher returns, better duration matching of liabilities and increased diversification. But respondents stated the need to overcome the hurdles of 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 over this time period.

Figure 8
Proportion of insurers citing intent to increase or decrease international allocation over the next three to five years



Note: Sample size by market: China 11, Hong Kong 7, Taiwan 8, S. Korea 5, Japan 12 ,Australia 34, Q15a. We are actively seeking to increase international allocation.

Source: Standard Life Investments Asia Pacific Insurance Survey 2017

Home bias to current allocations

In general, there is a strong home market bias to asset allocation due to local currency liabilities and regulatory incentives (see figure 6). In-house investment expertise is also focused on the home market, across both fixed income and equities.

Respondents told us that China's international allocations are starting from a very low base. At the end of 2016, the international allocation for the mainland Chinese industry as a whole was only 2%.

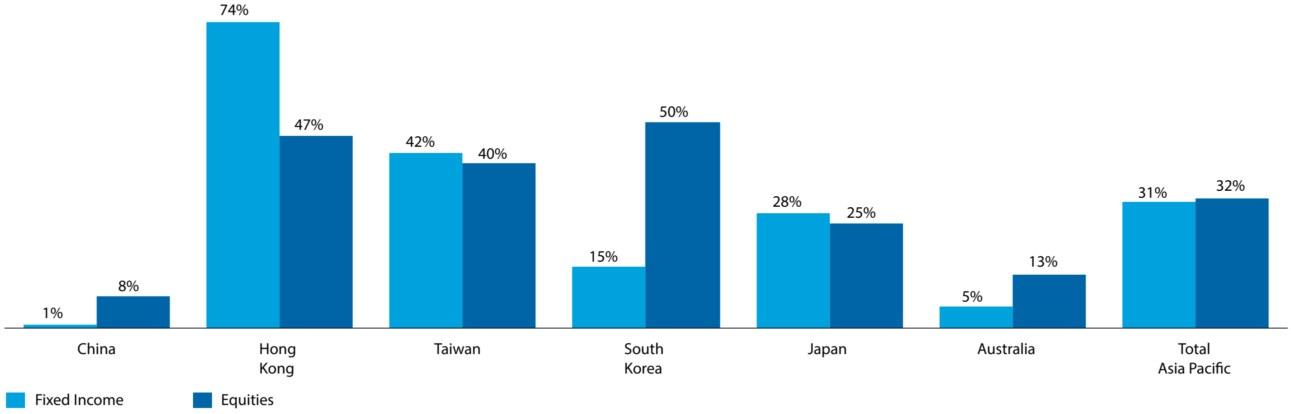
Hong Kong is an exception, with 74% of fixed income allocation invested internationally (see figure 9). The peg between the Hong Kong dollar and US dollar - in place since 1983 - means that much of the business conducted in Hong Kong is priced in US dollars, with US dollar assets held to match these liabilities.

With the Hong Kong dollar pegged to the US dollar, the Government effectively does our hedging for us. Furthermore, our liabilities can be in US dollars too.

Hong Kong life insurer

Figure 9

Current international allocation WITHIN asset classes



Note 1: Sample size by market: China 8, Hong Kong 7, Taiwan 7, S. Korea 4, Japan 11, Australia 5;
Note 2: In China, equities directly invested via SH/SZ exchanges are categorised as domestic, while investments via HK exchange offshore Q12.
How are your total assets split into the following asset classes?

Source: Standard Life Investments Asia Pacific Insurance Survey 2017

Drivers to going global: returns, liability matching and diversification

The survey identified three complementary drivers behind intentions to increase exposures to overseas markets (see figure 10). First, international markets provide a broader set of investment opportunities. This allows insurers to target higher returns. Second, they provide scope to increase diversification. Third, the markets in Europe and the US offer a greater depth and breadth than domestic markets and, crucially, offer longer dated bonds that allow better matching of longer dated liabilities.

"We would like to invest in 30-year US treasury bonds to increase our duration and enhance our yield"

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

Figure 10

Drivers of international allocations

The size of each word indicates its frequency or importance in responses.
Q16. Are you actively allocating or do you intend to allocate more assets internationally? If so what do you believe are the drivers of increasing international allocations?

Standard Life Investments Asia Pacific Insurance Survey 2017

Barriers to going global I: regulations

The survey also found three barriers to increasing international investments (see figure 11).

Figure 11

Barriers to increasing international allocations

Q15b. Increasing overseas allocation introduces a significant currency hedge issue, which offsets the benefits of investing offshore.

Standard Life Investments Asia Pacific Insurance Survey 2017

Regulatory barriers are a prominent feature, but differ across markets.

China has the toughest restrictions. There is a 15% cap on international allocations. Insurers must apply for quotas to invest internationally and, at the time of writing, these quotas have been suspended. In practice this means that allocations are well below this 15% cap. There are also higher capital charges on international assets relative to most domestic asset classes under local regulations.

In Taiwan, insurers are usually permitted to invest up to 45% of assets overseas. However, quotas are assigned based on two factors: the strength of the insurer's solvency position; and demonstrated internal investment and risk management capabilities.

In South Korea, there is a 30% cap on international allocation.

Insurers in Japan, Hong Kong and Australia face fewer regulatory barriers. There are no caps on international allocations in Hong Kong or Australia.

Barriers to going global II: hedging costs

Hedging costs were quoted as a significant barrier to overseas investment by 61% of insurers researched, most notably in Japan, South Korea and Taiwan (see figure 12). In Taiwan, the survey found that just three quarters of international assets are being hedged. The recent strength of the Taiwan dollar against the US dollar is reported to have resulted in significant losses to Taiwanese insurers.

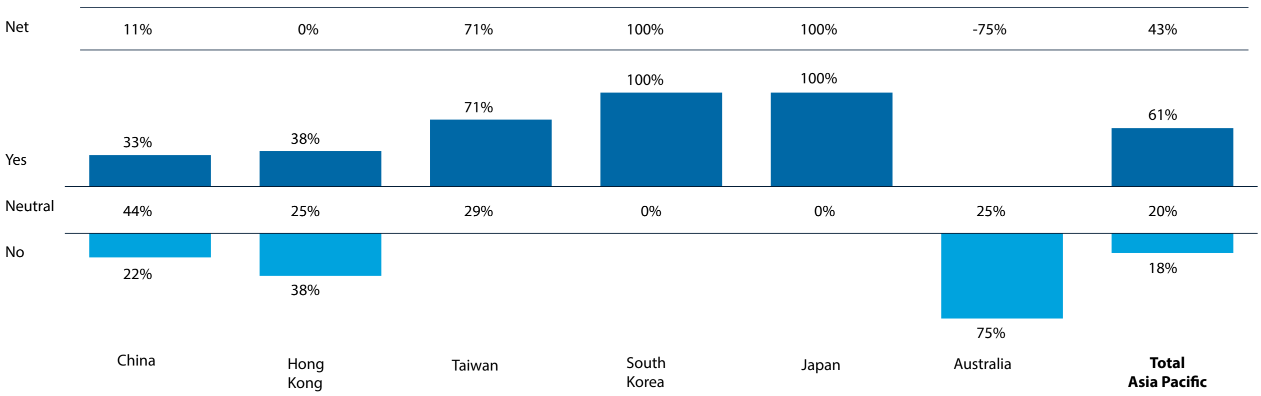
In contrast, mainland Chinese insurers generally do not hedge their international investments. The small allocations to overseas assets means the risk of holding unhedged investments is limited and these exposures can also provide potential upside in the event that the renminbi depreciates against other currencies.

Barriers to going global III: in-house capabilities

The survey found that a lack of local expertise was also a constraining factor. Issues cited included a lack of access to some markets and limited understanding of risks. Even outsourcing comes with hurdles since insurers need to have governance teams in place to oversee the activities of the external manager.

Figure 12

Will currency hedging be a major barrier to international allocation in the next three to five years



Note: Sample size by market: China 9, Hong Kong 8, Taiwan 7, S. Korea 4, Japan 12, Australia 4,
Q15b. Increasing overseas alloction introduces a significant currency hedge issue which offsets the benefits of investing offshore

Standard Life Investments Asia Pacific Insurance Survey 2017

Comparison of Asia Pacific 2017 and Europe 2015 Insurance Surveys

Europe

Theme 3

Insurers' investment freedom is constrained by Solvency II. This affects asset allocation as insurers balance greater risk appetite with optimising capital charges and the diversification benefits of the new regulations.

Insight

Insurers in both Europe and Asia Pacific are constrained from increasing risk appetites by a wide range of factors, but these constraints are greater in the less mature Asia Pacific markets.

The strong desire for more international allocation in Asia Pacific was not generally observed in Europe where local domestic and regional markets have wider and deeper pools of investment opportunities.

Theme 4:

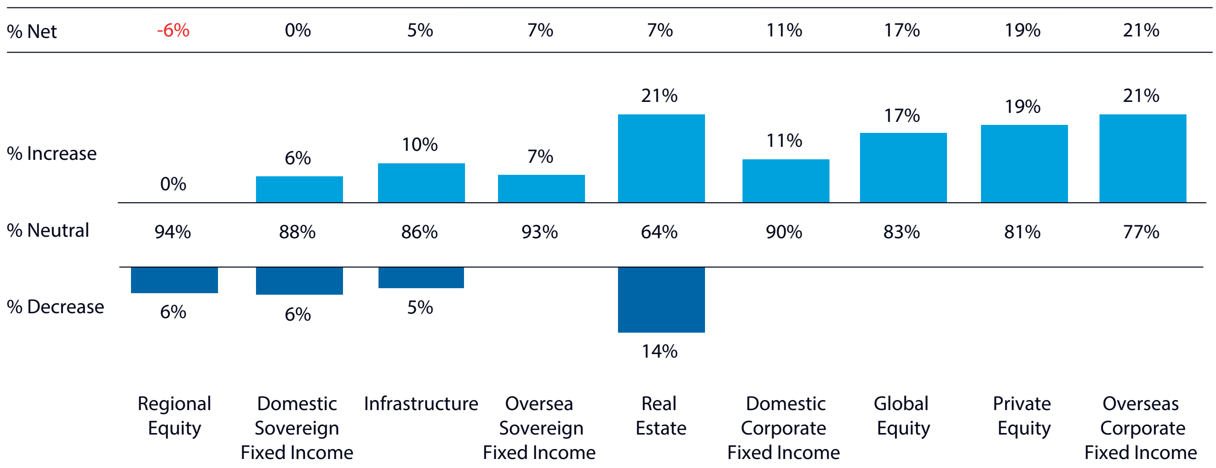
Trust in external managers?

In themes two and three, the insurers surveyed indicated intentions to increase strategic asset allocations to those asset classes where the use of external managers (asset managers outside the insurer or its affiliated companies) is highest: alternatives and international equities. Theme four explores both the gaps in insurers' investment capabilities and the barriers — real and perceived - to employing external managers.

- The proportion of Asia Pacific insurer assets managed by external managers is less than 20%, compared to 29% for their European peers.
- 76% of insurers surveyed expect the trend to increase alternative assets to drive more use of external managers.

Figure 13

Proportion of insurers intending to increase or decrease their use of external managers in the next three to five years



Note: 34 out of 51 respondents answered this question
Q23. Do you expect your allocations to external asset managers to increase, decrease or stay the same over the next three years by asset class?

Source: Standard Life Investments Asia Pacific Insurance Survey 2017

Internalising infrastructure?

The survey reveals an implicit reluctance to increase allocations to external managers, as illustrated by respondents' answers relating to infrastructure investments. 78% of insurers intend to increase exposure to infrastructure (figure 5). 48% of existing investments in infrastructure are held with external managers (see figure 14). Yet less than 10% of survey respondents expect infrastructure allocations managed by external managers to increase over the next three years, while 5% expect the externally managed allocation to decrease. This raises the question of whether insurers expect to manage more money in-house or whether the responses are a reaction to other barriers detailed overleaf.

Asset managers bring ideas from overseas, which are not new for them but are new for us.

Mainland Chinese life insurer

Drivers of external manager use

Insurers look to external managers to fill the gaps in their own investment expertise. They typically look for targeted skills: expertise in a specific asset class, country or market. The more experienced investment teams may even look for input on individual transactions, such as access to infrastructure projects or co-investment opportunities in private equity deals. Insurers lacking the scale to build internal investment teams will outsource broader investment mandates.

The use of external managers is highest in alternative asset classes and global equities (see figure 14), those asset classes highlighted as areas of intended growth in themes two and three.

External managers are also used when investment management is not seen as a core area of expertise by the insurer. This is most common for general and health insurance companies. The investment requirements of these insurers are generally relatively simple.

Barriers to external manager use

Interviews with participants revealed two types of barriers to the use of external managers. Some of these are structural impediments. Others can be overcome through a more constructive dialogue between the insurer and the asset manager.

Structural challenges to external manager use

There are regulatory incentives to build in-house capabilities. In Taiwan, the regulatory limits on international allocations depend on the insurer demonstrating internal capabilities in investment management, risk management, solvency and accounting. This makes it necessary to build in-house capabilities, even if this capability is simply there to provide governance over the activities of external managers.

Domestic markets provide some exposure to international investments. In particular, mainland Chinese insurers can invest in Hong Kong-listed stocks though the Stock Connect route. Although the Hong Kong market offers a limited universe of genuinely global businesses, it provides a route to gain at least some exposure to international investments without applying for an overseas investment quota or employing an external manager.

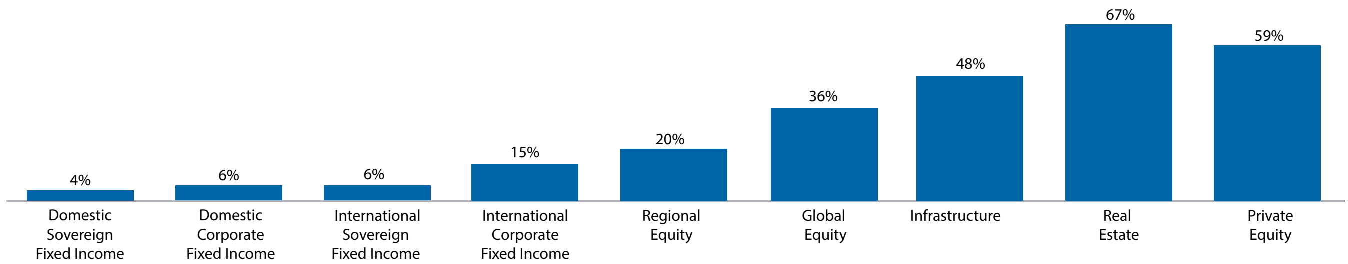
Some insurers have affiliated asset management companies, raising the barrier for employing truly third-party providers. There may be pressure to use these managers and keep profits within the group, even where the manager does not fill the identified skill gap. In Japan, the industry has consolidated into a small number of players, which often have either a partnership with an international manager or an internal investment team. Similarly in Hong Kong, there is a concentration of multinational insurers with established in-house investment capabilities.

Insurers are able to communicate more openly with an internal investment team than an external asset manager. They may not be able to divulge to third parties the sensitive information that lies behind their investment decisions. This can create tensions or disagreements with external managers.

The current strong regulatory capital positions of most Asia Pacific insurers also mean they believe they have time to build in-house capabilities.

Figure 14

Proportion of assets managed by external asset managers



Note: 43 out of 51 respondents answered this question.
Q22. Please indicate the proportion of each asset class held with external asset managers

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Delivering performance and demonstrating value for money

While these structural barriers may be hard to hurdle for external managers, there are a number of other barriers that the survey identified where the actions required are clearer (see figure 15). In general, the issues revolve around building trust in their ability to execute.

Delivering performance and understanding the underlying drivers topped the list of requirements for external managers.

> **Understanding performance is the biggest barrier to using external managers.**
>
> *Hong Kong life insurer*

Figure 15
Barriers to using external managers

Fees are seen as high. Insurers told us that fees do not correspond to the value added by the external managers. 68% of existing assets are actively managed, which compares to 78% for European insurers surveyed in 2015. Respondents indicated that they will continue to look for external active managers, but only those generating enough alpha to justify their fees.

"If we wanted to manage assets passively, we would not use an external manager"

Mainland Chinese life insurer

There is a mismatch in the measurement of performance between the insurers and external managers. Historically external managers have been measured on relative performance, even when the internal team is measured - and incentivised - on an absolute return basis, particularly where guaranteed returns are involved. This has increased interest in absolute return products that work better in modern solvency regimes.

Demonstrating an understanding of local issues

External managers may have a lack of local market knowledge. Few managers are able to demonstrate an understanding of the local regulatory regimes that are shaping the investment decisions of the insurers.

Overall, insurers believe that external managers should be able to play a greater role. But first they must take the time to understand local regulations, provide a meaningful contribution to the dialogue between actuarial and investment teams, and provide valuable investment insight. This will build trust in their ability to add value.

External managers know very little about regulation and we need to teach them instead of the other way.

Mainland Chinese life insurer

Comparison of Asia Pacific 2017 and Europe 2015 Insurance Surveys

Europe

Theme 4

Outsourcing asset management activity is increasingly attractive, but there are concerns about industry capacity and the number of asset managers able to meet complex insurer requirements.

Insight

While similar needs are identified, European insurers are more accepting of the value that external asset managers can bring, especially those with dedicated insurance capabilities.

External asset managers need to provide more evidence and convince clients of the benefits they can bring to Asia Pacific insurers due to bad experiences in the past, poor communication of performance, and a lack of specialist insurance asset managers in the region.

Theme 5:

Investment risk exposed

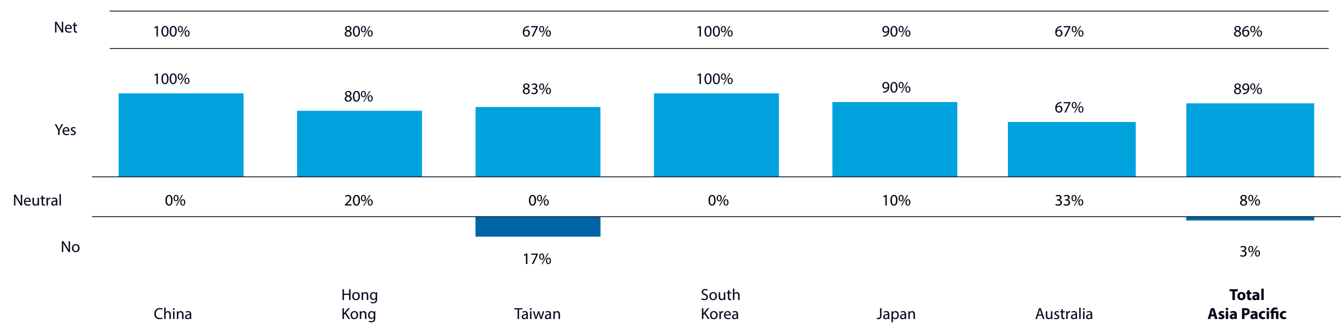
In this final theme, we explore the investment implications of the regulatory changes underway. This builds on the previous theme that concluded on the need for an understanding of the local regulations in each market.

- 89% of insurers surveyed indicated the need for closer collaboration between actuarial and investment teams.
- 51% told us that solvency regulations challenge their investment strategy while 46% told us that accountancy regulations challenge their investment strategy.

Regulations vary across the region but change is everywhere. There is a clear trend towards greater transparency on risk. This is driving a move towards more risk aware investment. This in turn is highlighting the need for a sharing of understanding between insurance experts and their investment colleagues (see figure 16). The way that investment decisions are made is fundamentally changing.

Figure 16

Proportion of insurers indicating the need for closer collaboration between actuarial and investment teams



Note: Sample size by market: China 8, Hong Kong 5, Taiwan 6, S. Korea 4, Japan 10, Australia 3,
Q32e. Regulation is driving a need for Actuarial and investment teams to work more closely together.

Source: Standard Life Investments Asia Pacific Insurance Survey 2017

Asia Pacific insurance markets and regulatory regimes are at very different stages of development. There is no regional solvency regime, in contrast to Europe where 2016 saw the introduction of Solvency II across the European Union. Nor is there a common accounting regime (neither in Asia Pacific nor around the world). Nevertheless, there is a strong and consistent move towards more risk-sensitive solvency regimes and market-based valuation within accounting regimes.

International accounting standards provide a specific example. IFRS 9 accounting is expected to be introduced in 2018 and will value certain assets at market value. Respondents feel that this will increase the volatility of reported profits. IFRS 17 is due in 2021 and will mean, for example, that losses on unprofitable guaranteed business will be explicitly reflected in profit and loss accounts.

On Thursday, the International Accounting Standards Board will launch a new set of regulations, IFRS 17, designed to simplify insurer' notoriously complex financial statements. The standard has taken 20 years to develop and will cost billions to implement.

Mainland Chinese life insurer

Specifically on risk sensitive solvency regimes, the International Association of Insurance Supervisors is developing a global Insurance Capital Standard and, while adoption of international solvency standards is not compulsory for Asia Pacific markets, there is a strong desire to move in this direction in line with international insurance markets.

Investment implications of regulatory change

The consequences of investing in risk assets will become more transparent as accounting and solvency regimes become more risk sensitive and market based. So too will the risks of running mismatched assets and liabilities. This has real - and potentially significant - commercial consequences for Asia Pacific insurers.

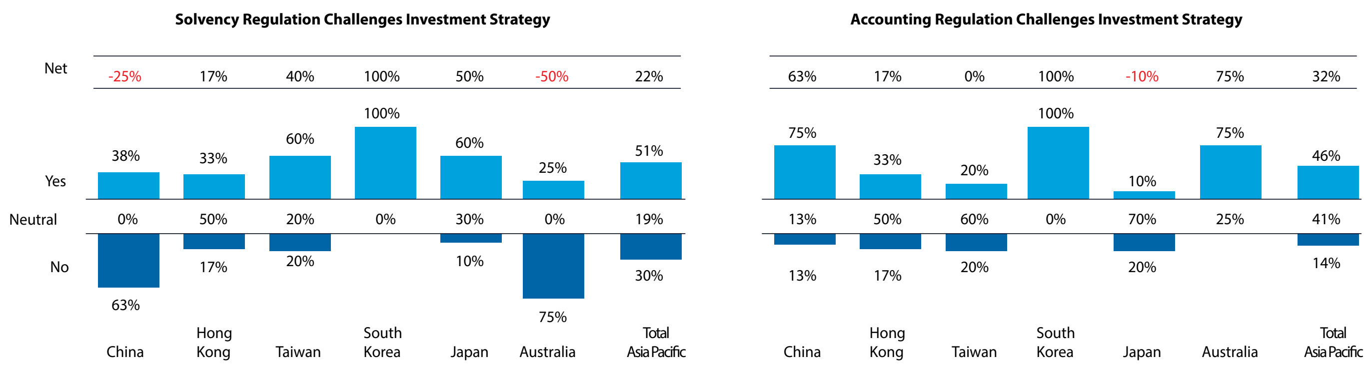
The challenge increases when there is a disconnect between accounting and solvency standards as they transition from book-based to market-based regimes. When these changes are not aligned, the investment decisions are further complicated.

The main challenge for Hong Kong insurers is not mark-to-market, but the tedious aggregation process as loss-making policies are required to be reported in the future, and par products have to be invested in a defined mix of investments to qualify for the variable fee approach to reduce volatility in profit and loss.

Hong Kong life insurer

Figure 17

Proportion of insurers citing regulation as a major challenge to investment strategy in the next three to five years



Note: Sample size by market: China 8, Hong Kong 6, Taiwan 5, S. Korea 4, Japan 10, Australia 4.
Q32. To what extent do you agree with the following statements? LHS: Solvency-related regulation will pose a significant challenge to our current investment strategy and execution. RHS: Accounting-based regulation will pose a significant challenge to our current investment strategy and execution.

Regulation exposing investment risk and driving collaboration

A key insight from the research is that all this change is driving a strong need for greater collaboration between investment and actuarial teams. Increasingly the two teams are collaborating before investment decisions are made. If an investment introduces a duration mismatch, for example, the resulting potential increase in both profit and loss (P&L) volatility and regulatory solvency capital may mean that the investment no longer makes sense.

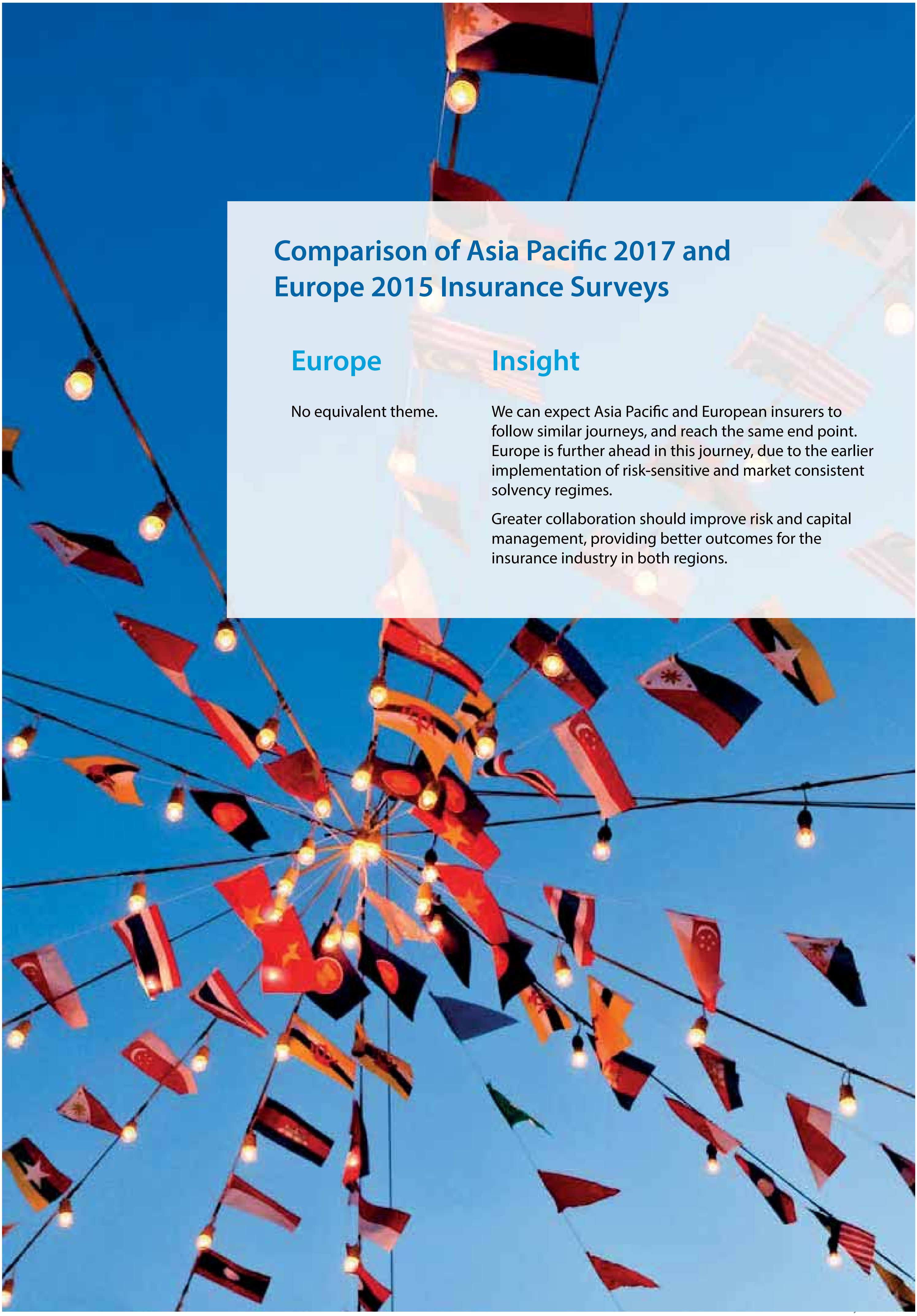
Modern regulations highlight the risks of more volatile asset classes, increasing the capital requirements. Insurers are responding by assessing more capital efficient investments, including absolute return funds and capital protected strategies, with actuarial and investment teams working closely together on these assessments.

Example: Asset-liability mismatch risk in China

Respondents confirmed that China is set to release new regulations in the middle of 2017 to quantify and assess asset liability management (ALM) risk for insurers. This will supplement existing C-ROSS requirements. Mainland Chinese insurers have seen rapid growth in sales of short-term, high guaranteed return products. The associated assets have been invested in longer-term illiquid loans to generate returns sufficient to pay for guarantees, creating a duration mismatch. As these assets account for up to 25% of the investment portfolios, any change in rules will have significant implications for investment strategy.

IFRS will bring in mark-to-market, which will have a major impact on our P&L, and may mean we will not be able to invest in as-risky assets.

South Korean non-life insurer



Comparison of Asia Pacific 2017 and Europe 2015 Insurance Surveys

Europe	Insight
No equivalent theme.	We can expect Asia Pacific and European insurers to follow similar journeys, and reach the same end point. Europe is further ahead in this journey, due to the earlier implementation of risk-sensitive and market consistent solvency regimes. Greater collaboration should improve risk and capital management, providing better outcomes for the insurance industry in both regions.

Conclusion

The research collates the views of the participants 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 the 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 the 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.

Market Focus

Australia

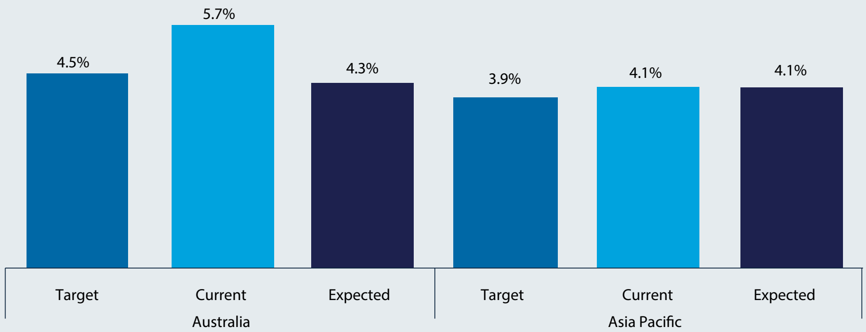
Overview

- Life insurance products sold today are pure protection
- Guaranteed savings products are no longer offered following the introduction of a comprehensive superannuation system introduced in 1992. Investment-linked products are usually linked to superannuation and legacy guaranteed annuity products are low in volume
- Future market premium growth is likely to be at the rate of inflation plus age-related increases (stepped premium products). There is little genuine growth in the system
- Largest life insurers are the multinationals, TAL (owned by Dai-Ichi) and AIA, followed by the local bank-owned life insurers: MLC, CommInsure and OnePath

Guaranteed Savings Product Returns

- Guaranteed savings product returns in 2016 were above Asia Pacific average. Note that interest rates in Australia are also higher than in many regional markets
- However, life insurance industry returns in 2016 were the lowest since 2011

Returns on Guaranteed Savings Products (2016)

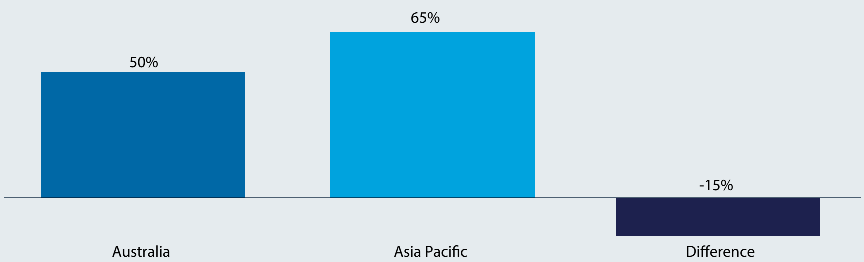


Source: Standard Life Investments Asia Pacific Insurance Survey 2017

Allocation to Alternatives

- Since guaranteed savings products are legacy (and profitable), there is less pressure to boost returns in Australia compared to the regional markets
- Allocation to cash and domestic corporate bonds are higher in Australia than in regional markets
- Asset-liability matching is not a major concern

Net Proportion of Respondents Intending to Increase Alternatives Allocation (2016)



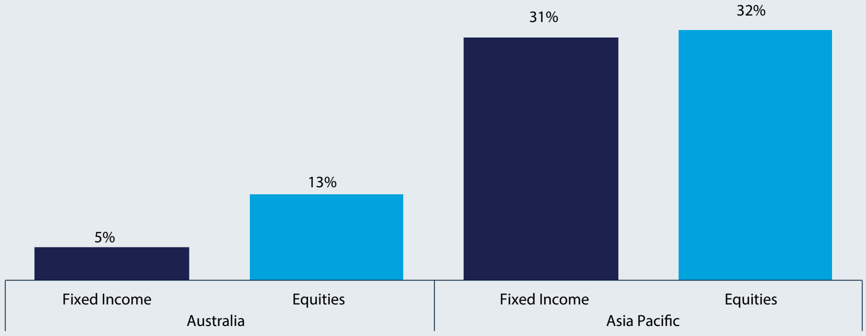
Source: Standard Life Investments Asia Pacific Insurance Survey 2017

Australia

International Allocation

- There are no caps on international allocations. In fact, regulations in the target investment country, such as US Company Law, have been cited as larger barriers than local restrictions
- Franking credits are unique to Australia and act as a tax incentive for insurers to invest in domestic equities

Proportion of International Assets (2016)



Source: Standard Life Investments Asia Pacific Insurance Survey 2017

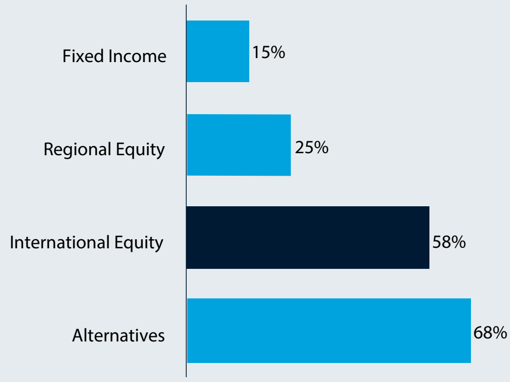
Regulation

- The current Solvency regime, LAGIC, is an advanced risk-based capital regime introduced in 2013
- Insurers cited LAGIC as being strict on international allocations and this is one of the reasons for them holding lower allocations to international assets than regional peers
- Accounting assets and liabilities are both marked-to-market and insurers cite that IFRS 9 and IFRS 17 will have little impact even if they are introduced
- The regulatory environment is stable and there were few cited regulatory changes on the horizon that will have a major impact on insurer asset management

External Asset Managers

- Usage of external asset managers is relatively higher in Australia than in other regional markets
- Life insurers put less emphasis on investment management as a point of differentiation due to the prevalence of simple life products offering pure protection
- Insurers use external managers for access to investments they would not be able to access themselves

Proportion of Assets Managed by External AMs (2016)



Source: Standard Life Investments Asia Pacific Insurance Survey 2017

Market Focus

China

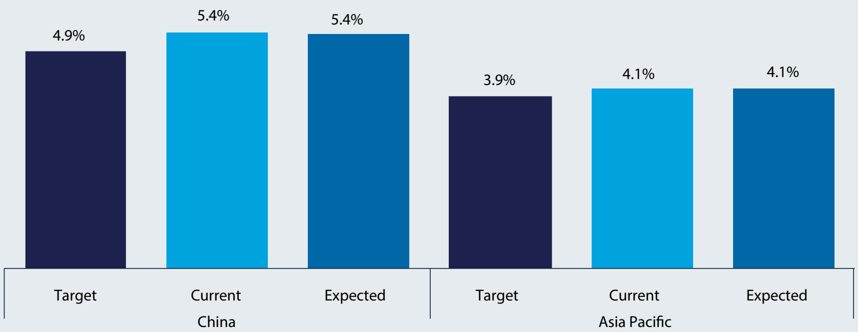
Overview

- High growth market with life insurance premiums increasing by 28% in 2016
- Future rate of growth expected to be lower due to regulatory tightening on short-term, wealth management products
- Guaranteed savings products dominate market, particularly participating guaranteed savings products
- Largest life insurers are domestically-owned. Top three are China Life, Ping An Life and China Pacific Life
- Market is challenged and shaped by regulation, which is more dynamic – and less stable – than in other Asia Pacific markets

Guaranteed Savings Product Returns

- Guaranteed savings product returns in 2016 were above Asia Pacific average, driven by higher interest rates and returns
- Above target returns were driven by insurers holding high proportion of illiquid fixed income investments, often linked to infrastructure and government financing, together with caps on product guarantees

Returns on Guaranteed Savings Products (2016)

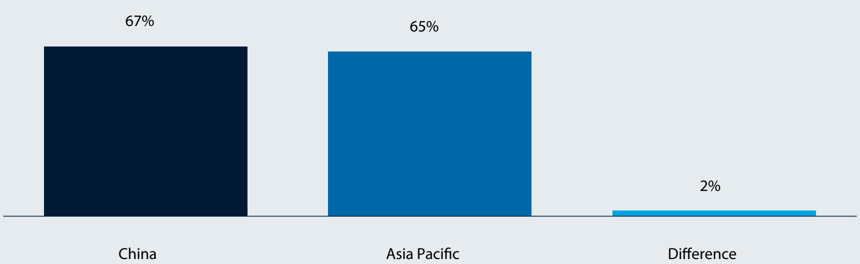


Source: Standard Life Investments Asia Pacific Insurance Survey 2017

Allocation to Alternatives

- Higher than Asia Pacific average allocations to alternatives when 'alternative loans' are included. These are loans which include illiquid bonds and trust products, often linked to infrastructure and local government financing
- Insurers are not allowed to invest in residential property and there are restrictions on investing in hedge funds

Net Proportion of Respondents Intending to Increase Alternatives Allocation (2016)



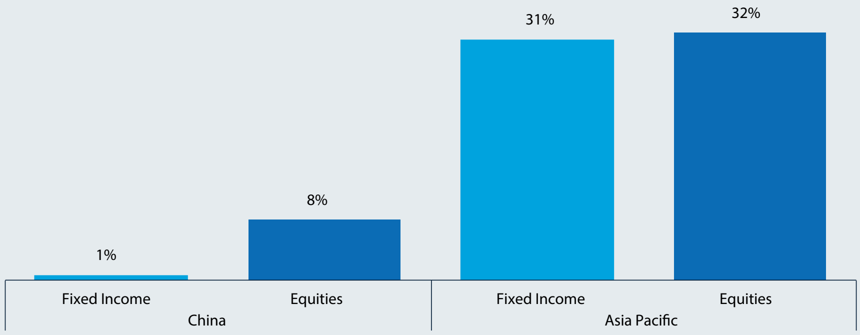
Source: Standard Life Investments Asia Pacific Insurance Survey 2017

China

International Allocation

- Significantly lower than Asia Pacific average allocation to international assets due to a 15% cap on international investment (for insurers which qualify to invest offshore), capital outflow tightening in 2016 and perceived better opportunities in the home market
- 64% of insurers indicate that they seek to increase international allocation over the next three to five years

Proportion of International Assets (2016)



Source: Standard Life Investments Asia Pacific Insurance Survey 2017

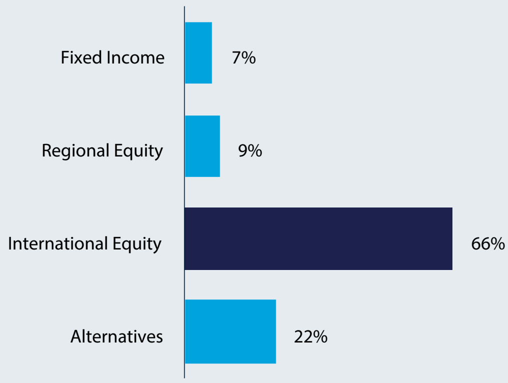
Regulation

- C-ROSS was implemented in 2016 and is a Solvency II style risk-based capital regime. However, C-ROSS has characteristics which are uniquely tailored to China, most notably lower capital charges for property and higher capital charges to international assets than Solvency II
- Larger insurers indicate that C-ROSS has been positive for them as they have more advanced capabilities relative to their smaller counterparts and hence are better positioned to identify new risk-adjusted opportunities
- Insurers in China cite accounting regulation as a continual challenge. In particular, insurers cite the adoption of IFRS 9 (expected in 2018), which will move reporting in the P&L from book-based to market-based

External Asset Managers

- Sentiment towards the use of external managers is mixed, despite the relative lack of group-wide investment capabilities or the formal partnerships with external managers, that are common in Hong Kong and Japan
- Insurers cite the external managers as lacking local market and regulatory understanding

Proportion of Assets Managed by External AMs (2016)



Source: Standard Life Investments Asia Pacific Insurance Survey 2017

Market Focus

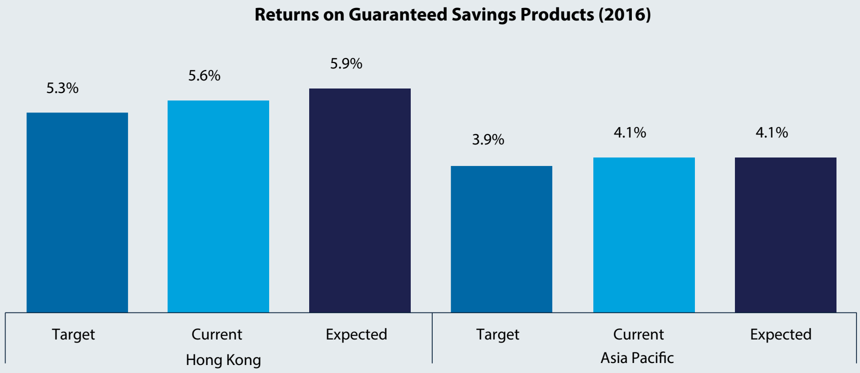
Hong Kong

Overview

- Medium growth market, with life insurance premiums increasing by 12% in 2015
- Future rate of growth expected to be lower as regulation on mainland Chinese visitors purchasing life policies in Hong Kong are tightened and enforced
- Guaranteed savings products dominate market, particularly participating guaranteed savings product
- Largest life insurers are multinational companies. Top three are AIA, Prudential and China life
- Market is challenged by the prospect of lower future growth as regulation tightens on mainland Chinese visitors purchasing life insurance in Hong Kong. Insurers are seeking alternative sources of growth

Guaranteed Savings Product Returns

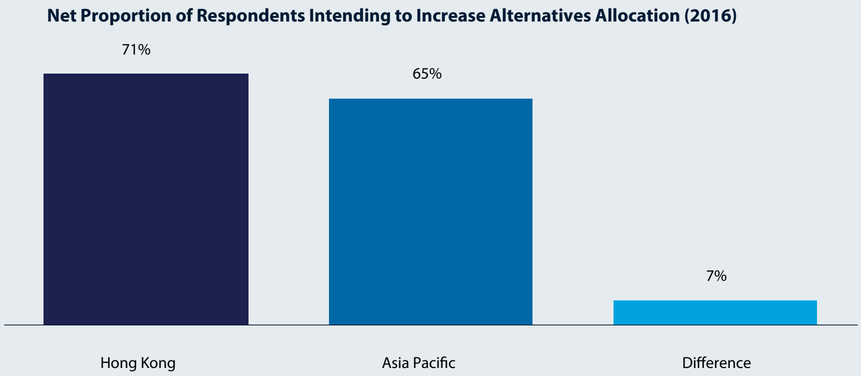
- Guaranteed savings product returns in 2016 were above Asia Pacific average driven by relatively higher interest rates and unrestricted access to offshore investments
- Similarly, above target returns in 2016 were also driven by unrestricted access to offshore investments



Source: Standard Life Investments Asia Pacific Insurance Survey 2017

Allocation to Alternatives

- Better access to offshore alternative assets and alternative investment capabilities than regional peers via group-wide investment capabilities
- A rules-based solvency regime may not be fully risk sensitive to alternative investments



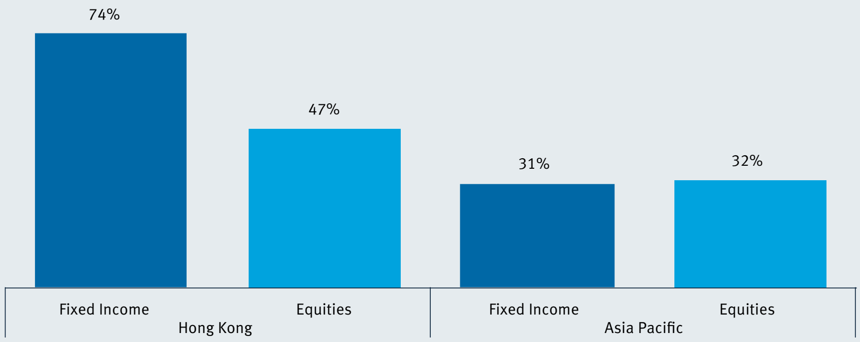
Source: Standard Life Investments Asia Pacific Insurance Survey 2017

Hong Kong

International Allocation

- Significantly higher allocation to international assets, especially to the US, as the local Hong Kong Government and corporate bond markets are small and illiquid and the Hong Kong dollar is pegged to the US dollar, minimising exchange rate risk
- 71% of insurers indicate that they seek to increase international allocation over the next three to five years

Proportion of International Assets (2016)



Source: Standard Life Investments Asia Pacific Insurance Survey 2017

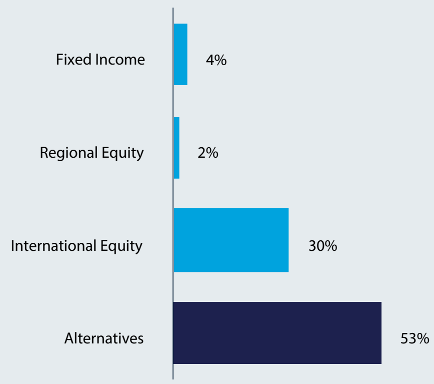
Regulation

- The current Solvency regime is rules-based (EU Solvency I) and may not be fully risk sensitive. However, the Government is currently studying the possibility of introducing an advanced, Solvency II style capital regime by 2020
- European insurers that are headquartered in a Solvency II market have to comply with both Solvency II and local Hong Kong regulation
- The current accounting standards, HKFRS, are book-based. Potential introduction of IFRS 9 and IFRS 17 will move reporting to be market-based
- Insurers are currently lobbying for their US-style par products to qualify for the Variable Fee Approach under IFRS 17. This will provide more stability in P&L reporting

External Asset Managers

- Multinational insurers have access to significant group-wide investment capabilities
- Insurers cite the difficulties in understanding performance and communication with external managers as the biggest barriers to using external managers

Proportion of Assets Managed by External AMs (2016)



Source: Standard Life Investments Asia Pacific Insurance Survey 2017

Market Focus

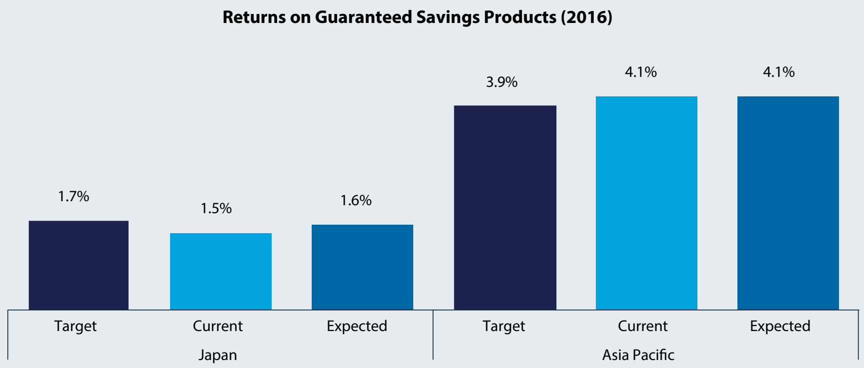
Japan

Overview

- Low growth market, with premiums increasing by 3 percent in 2016
- Future rate of growth expected to remain low as penetration is already high, market is mature and population growth is low
- Guaranteed savings products dominate the market, though there is evidence of a shift towards more investment-linked products
- Largest life insurers are domestically-owned. Top 3 are Japan Post, Nippon Life and Dai-Ichi Life
- Market is challenged by the prospect of continuing low growth, the low return environment and unfavourable demographics

Guaranteed Savings Product Returns

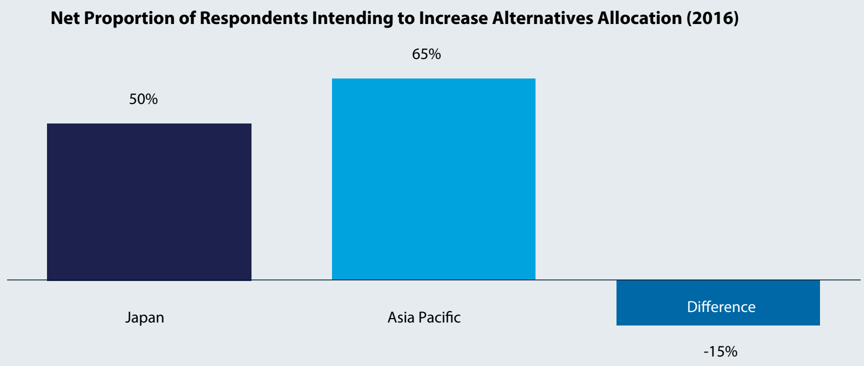
- Guaranteed savings product returns in 2016 were below Asian average
- Returns were below target due to the low return environment and conservative investment strategies, which are heavily weighted to Japanese Government Bonds



Source: Standard Life Investments Asia Pacific Insurance Survey 2017

Allocation to Alternatives

- Asset-liability matching is an issue and insurers seek higher allocations to infrastructure debt to address this issue
- Japanese insurers expressed no intent to allocate more to real estate (in contrast to other Asian insurers) as a result of the negative experience of real estate investments in the 1980s and 1990s



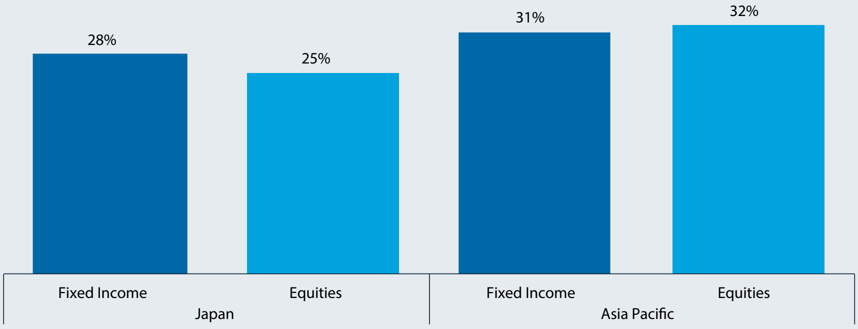
Source: Standard Life Investments Asia Pacific Insurance Survey 2017

Japan

International Allocation

- Japanese insurers face minimal regulatory barriers to international allocations
- Search for higher yield drives international allocations
- 83 percent of insurers indicate that they seek to increase international allocation over the next 3 to 5 years

Proportion of International Assets (2016)



Source: Standard Life Investments Asia Pacific Insurance Survey 2017

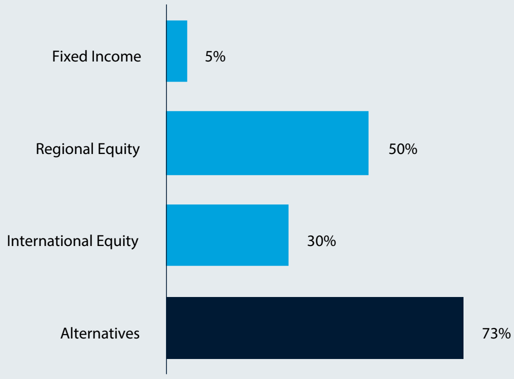
Regulation

- The current Solvency regime is a first generation risk-based capital regime. Insurers are concerned that a Solvency II style capital regime will be introduced in the next 3 to 5 years
- Insurers also expressed concern regarding the potential introduction of IFRS 9 and IFRS 17, as mark-to-market will result in higher volatility in the P&L, lower appetite for more volatile, higher yielding assets and recognition of unprofitable guarantees sold
- However, compared to other Asian markets, regulation in Japan is more stable and seen to have a lower impact on investment strategy

External Asset Managers

- The consolidation of the life insurance industry in the 1990's has left a small number of large conglomerates that often have partnerships with international managers or own managers, making it harder for new entrants
- These conglomerates form loose alliances and there are barriers for members of different alliances to collaborate
- FSA initiatives to increase access to the investment management industry will make it easier for insurers to work with external managers in the future

Proportion of Assets Managed by External AMs (2016)



Source: Standard Life Investments Asia Pacific Insurance Survey 2017

Market Focus

South Korea

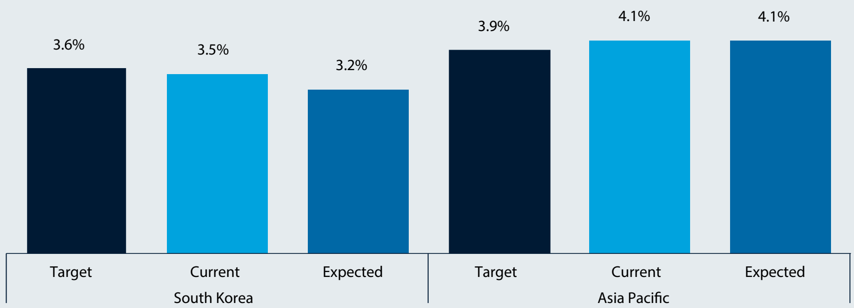
Overview

- Medium growth market, with premiums increasing by 12% in 2016
- Future rate of growth will most likely be slow as insurers struggle to offer attractive guarantees to customers
- Guaranteed savings products dominate the market, though there is evidence of a shift to investment-linked products
- Largest life insurers are domestically-owned. Top three are Samsung Life, Hanwha Life and Kyobo life
- Market is challenged by the prospect of future stagnant growth, the low return environment and perceived political instability

Guaranteed Savings Product Returns

- Guaranteed savings product returns in 2016 were below Asia Pacific average
- Returns were below target due to the low return environment, lack of opportunities in local equity and bond markets and offshore investment restrictions

Returns on Guaranteed Savings Products (2016)

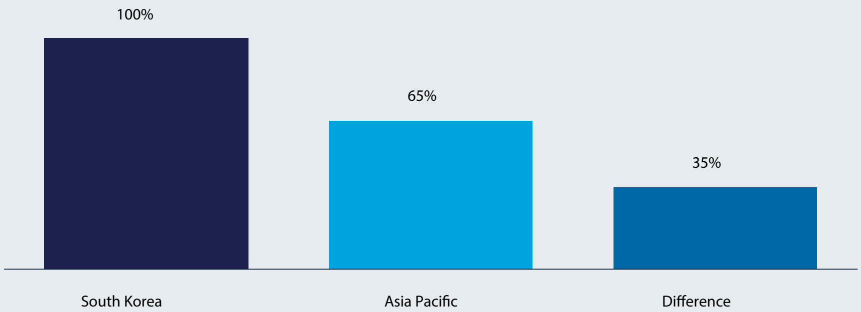


Source: Standard Life Investments Asia Pacific Insurance Survey 2017

Allocation to Alternatives

- Similar to in China, South Korean insurers also cited allocations which are not fully commercially motivated
- Asset-liability matching is an issue and insurers seek greater allocation to infrastructure debt and real estate to address this issue

Net Proportion of Respondents Intending to Increase Alternatives Allocation (2016)



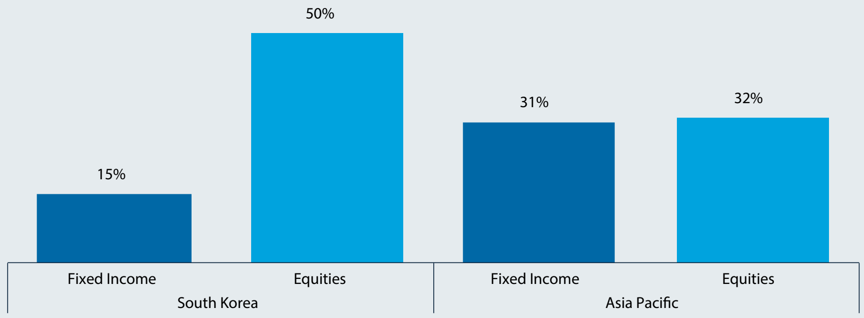
Source: Standard Life Investments Asia Pacific Insurance Survey 2017

South Korea

International Allocation

- International allocation is capped by regulation at 30% but insurers expect this cap to be subject to review
- Insurers expressed particular interest in 30-year US bonds, both for higher yield and better matching of the duration of liabilities
- 80% of insurers indicate that they seek to increase international allocations over the next three to five years

Proportion of International Assets (2016)



Source: Standard Life Investments Asia Pacific Insurance Survey 2017

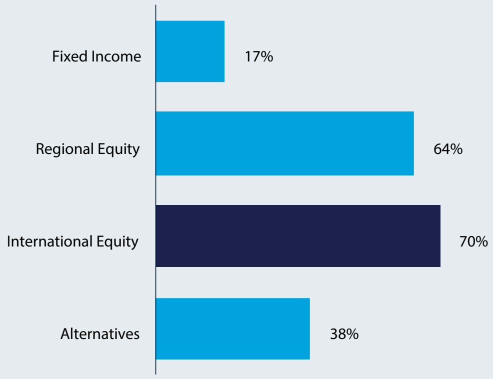
Regulation

- The current solvency regime is a first generation risk-based capital regime. Insurers cite a high likelihood that a Solvency II style capital regime will be introduced by 2020, but adapted to local market dynamics
- All insurers are concerned regarding the potential introduction of IFRS 9 and IFRS 17, as mark-to-market will result in higher volatility in the P&L, lower appetite for more volatile, higher-yielding assets and recognition of unprofitable guarantees sold
- A review is currently underway on whether capital charges should also apply to the Special Account (“SA”). Currently, capital charges only apply to the General Account and many risky assets are pushed into the SA

External Asset Managers

- South Korea appears to be the market where external managers can add the most value as almost every insurer interviewed indicated the desire to pursue higher allocations to alternatives and international assets, but lack the internal capabilities to carry this out

Proportion of Assets Managed by External AMs (2016)



Source: Standard Life Investments Asia Pacific Insurance Survey 2017

Market Focus

Taiwan

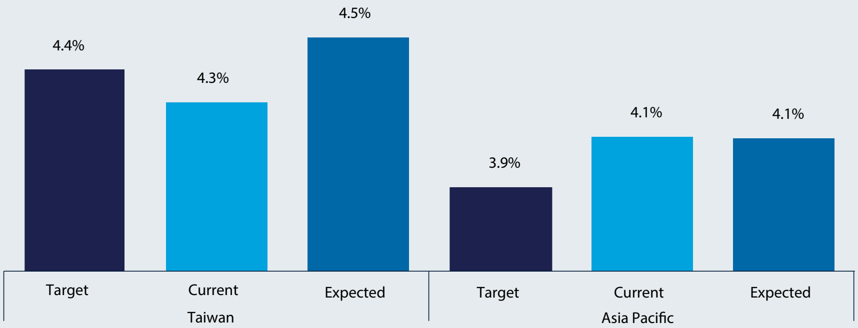
Overview

- Medium growth market with premiums increasing by 10% in 2016
- Future rate of growth will most likely be slow as penetration is already high, though there will be pockets of growth such as long-term care insurance
- Guaranteed savings and investment-linked products dominate the market
- Largest life insurers are domestically-owned. Top three are Cathay Life, Fubon Life and Nan Shan Life
- Market is challenged by the prospect of future stagnant growth, the low return environment and regulation that is seen to be too tight and not sufficiently commercially focused

Guaranteed Savings Product Returns

- Guaranteed savings product returns in 2016 were marginally above Asia Pacific average
- However, returns were below target. Investment opportunities are constrained as local equity and bond markets lack capacity and depth, but offshore investments are restricted

Returns on Guaranteed Savings Products (2016)

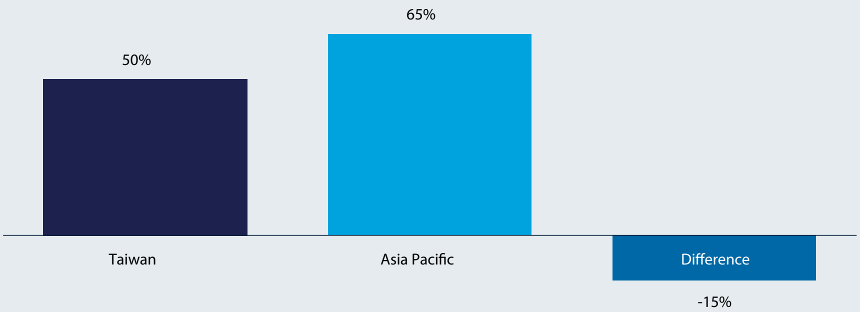


Source: Standard Life Investments Asia Pacific Insurance Survey 2017

Allocation to Alternatives

- Alternative investments are capped by regulation, subject to insurers' solvency strength
- Asset-liability matching is an issue in Taiwan and insurers seek greater allocation to infrastructure debt and real estate to address this issue

Net Proportion of Respondents Intending to Increase Alternatives Allocation (2016)



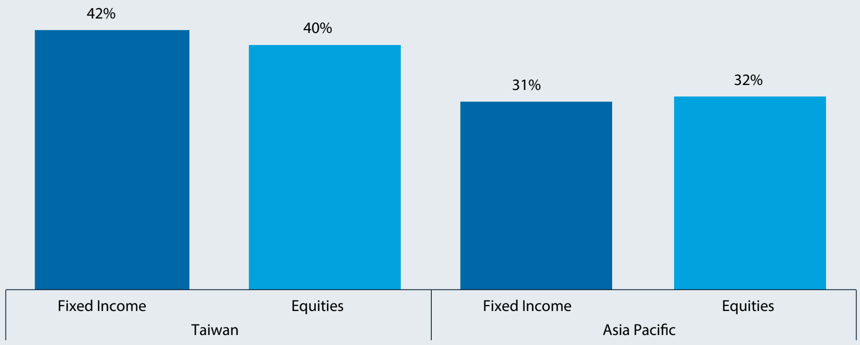
Source: Standard Life Investments Asia Pacific Insurance Survey 2017

Taiwan

International Allocation

- High international allocations relative to regional peers as local market lacks capacity and depth
- However, international allocation is capped by regulation, with higher caps granted to insurers that can prove advanced investment and risk management capabilities
- 88% of insurers indicate that they seek to increase international allocation over the next three to five years

Proportion of International Assets (2016)



Source: Standard Life Investments Asia Pacific Insurance Survey 2017

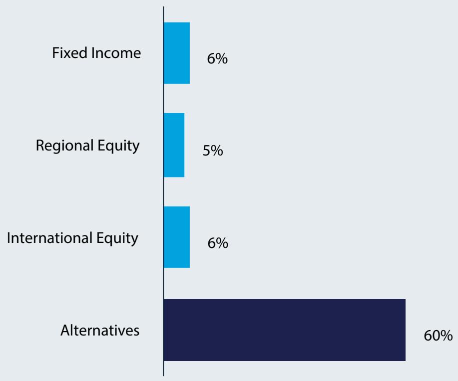
Regulation

- The current solvency regime is a first generation, risk-based capital regime. There is potential for a more advanced capital regime to be introduced. However, insurers interviewed expressed mixed views on the likelihood of this happening over the next three to five years
- Similarly, the current accounting standards are book based, but insurers expressed mixed views on whether the market will move towards market based IFRS 9 and IFRS 17 over the next three to five years
- Insurers' sentiment towards existing regulation and the regulator's approach to regulation was the most negative out of all Asia Pacific markets researched

External Asset Managers

- Sentiment towards external manager use was the most negative in Taiwan out of all Asia Pacific markets researched
- Insurers are more likely to take a 'trading' approach to investment decisions for the pursuit of absolute returns
- Offshore allocation caps based on proof of internal capabilities provide incentives for insurers to build in-house investment capabilities

Proportion of Assets Managed by External AMs (2016)



Source: Standard Life Investments Asia Pacific Insurance Survey 2017

Aberdeen Standard Investments insurance solutions

Stephen Acheson
Global Head of Insurance

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