Inside insurance

The new paradigm in Asian insurance

April 2021

"My most important decisions are always made with instinct, intuition, taste, heart – not analysis."

– Jeff Bezos, CEO and Founder, Amazon

For insurance investors, all important decisions are made by analysis – and the analysis required is getting more complicated. In Asia, insurance investment is entering into a long-term "paradigm shift." This structural change is not just shaped by the pandemic and recent volatility in equity and bond yields, but also by many structural factors, such as the continued low interest rate environment, the adoption of new risk-based capital (RBC) regimes and IFRS 9/17 accounting rules, and the intense product competition in the region.

In this new paradigm, where the rules and objectives are changing, insurance investors need to be prepared in three ways before entering the new arena: a new mindset for the game, new set of weapons to attack and a strong shield for defense.

1. A new mindset for the game

A strategic asset allocation (SAA) is of paramount importance to guide insurers through regulatory changes and market uncertainties to come. The new paradigm for insurance investment requires fundamental changes to a company's SAA model, starting with the input. Insurers need better and broader asset assumptions to define the full investment universe – both locally and on a global scale. Limiting options to existing asset classes or one region often results in sub-optimal long-term investment results and an inefficient use of capital.

The next step is to feed the new assumptions into a powerful SAA engine. Insurers need to expand the simple return/volatility model into a multi-dimensional SAA model that can incorporate most of the new risk, capital and accounting metrics.

2. New weapons to attack

Asia CIOs need a new set of tools to search for yield in a low-yield environment and volatile market. Our 2021 Long-Term Capital Market Assumptions (LTCMAs) highlight that while we are optimistic about the new business cycle post-Covid, we believe traditional balanced portfolios, e.g. with a 60% equity/40% fixed income allocation will be challenged over the next decades. To generate returns, investors will need to seek out new strategies and new asset classes. For Asian insurers, these new investments can range from non-core fixed income to the entire spectrum of alternative assets.

INSIDE INSURANCE

Inside Insurance provides a regular round up of the key trends in the insurance market, as observed by the J.P. Morgan Asset Management Global Insurance Solutions Strategy & Analytics team. The aim is to provide insurers with all the information they need to stay up-to-date with breaking industry news, product developments and regulatory changes. Our experienced "actuarial influencers" spend time talking to a broad range of insurance clients to gather the latest news, taking the time to read research papers and regulatory reports so that you don't have to.

Author

Rick Wei, FSA, FCIA, CERA

Head of Asia ex-Japan Insurance Strategy

More insurers are sourcing assets outside of their home market for income, alpha and diversification. We are in the view that the greater use of active management will continue to be a common approach in Asia for dealing with low bond yields. Within fixed income, Asian insurers are actively searching for yield in emerging market debt and selective high-yield U.S. and Asian credits. Outside of fixed income, alternative assets are transitioning from optional to essential for insurance companies in Asia. We believe Asia's total asset allocation to alternatives will increase from today's low single digit level to 10-15% of portfolios in the next five years.

3. A strong shield for defense

Searching for yield in today's market may come with higher risks. Before using the new set of tools, insurance investors need to build a strong shield to protect the portfolio from unwanted risk such as accounting/solvency volatility, prohibitive risk capital, asset-liability mismatch and concertation risk.

While there is no one-size-fits-all solution to eliminate all these risks, at J.P. Morgan Asset Management, we have helped insurers across the globe build fortresses with their balance sheets and capital positions under different RBC regimes and accounting and tax rules. Instead of a SAA overhaul, innovative and effective RBC solutions are expected to help insurers build strong defensive shields to save risk capital, lower accounting volatility and reduce economic losses.

From European Solvency II to Asia RBCs, we have identified the following solutions generally to be effective and relevant in many Asian markets:

- Capital-efficient fixed income portfolio construction could decrease the spread risk charge on fixed income portfolios.
- Matching adjustment (MA) portfolios could reduce policy liability, eliminate MA portfolio solvency volatility and increase the product pricing interest rate.
- Equity hedging strategies with derivatives, if implemented in a systematic and structural way, could significantly reduce the equity risk charge, protect from downside risk and improve both risk-adjusted and capital-adjusted returns.
- Currency hedging solutions allow investors to invest in overseas assets without incurring a foreign currency risk charge.
- Construction of optimal and diversified alternative portfolios could achieve capital efficiency, income, alpha and downside protection. This could be accomplished by optimally allocating to core strategies for stable cash yields and diversification, and to opportunistic strategies for higher returns. Instead of only seeking alpha, Asian insurers are increasingly focusing on capital efficiency, income, asset liability management and diversification in their alternative allocation decisions.

Structural paradigm shift – from persistent low interest rates to risk-based capital regimes and new accounting rules – have changed the game plan for Asian insurers. Insurers need to update their thinking on strategic asset allocations and upgrade their toolbox to achieve higher yields, while continuing to build strong defense and protect portfolios from unwanted risks.

NOT FOR RETAIL DISTRIBUTION: This communication has been prepared exclusively for institutional, wholesale, professional clients and qualified investors only, as defined by local laws and regulations.

This is a promotional document and is intended to report solely on investment strategies and opportunities identified by J.P. Morgan Asset Management and as such the views contained herein are not to be taken as advice or a recommendation to buy or sell any investment or interest thereto. This document is confidential and intended only for the person or entity to which it has been provided. Reliance upon information in this material is at the sole discretion of the reader. The material was prepared without regard to specific objectives, financial situation or needs of any particular receiver. Any research in this document has been obtained and may have been acted upon by J.P. Morgan Asset Management for its own purpose. The results of such research are being made available as additional information and do not necessarily reflect the views of J.P. Morgan Asset Management. Any forecasts, figures, opinions, statements of financial market trends or investment techniques and strategies expressed are those of J.P. Morgan Asset Management, unless otherwise stated, as of the date of issuance. They are considered to be reliable at the time of production, but no warranty as to the accuracy and reliability or completeness in respect of any error or omission is accepted, and may be subject to change without reference or notification to you.

Investment involves risks. Any investment decision should be based solely on the basis of any relevant offering documents such as the prospectus, annual report, semi-annual report, private placement or offering memorandum. For further information, any questions and for copies of the offering material you can contact your usual J.P. Morgan Asset Management representative. Both past performance and yields are not reliable indicators of current and future results. There is no guarantee that any forecast will come to pass. Any reproduction, retransmission, dissemination or other unauthorized use of this document or the information contained herein by any person or entity without the express prior written consent of J.P. Morgan Asset Management is strictly prohibited.

J.P. Morgan Asset Management or any of its affiliates and employees may hold positions or act as a market maker in the financial instruments of any issuer discussed herein or act as the underwriter, placement agent or lender to such issuer. The investments and strategies discussed herein may not be appropriate for all investors and may not be authorized or its offering may be restricted in your jurisdiction, it is the responsibility of every reader to satisfy himself as to the full observance of the laws and regulations of the relevant jurisdictions. Prior to any application investors are advised to take all necessary legal, regulatory and tax advice on the consequences of an investment in the products.

Securities products, if presented in the U.S., are offered by J.P. Morgan Institutional Investments, Inc., member of FINRA.

J.P. Morgan Asset Management is the brand for the asset management business of JPMorgan Chase & Co. and its affiliates worldwide.

To the extent permitted by applicable law, we may record telephone calls and monitor electronic communications to comply with our legal and regulatory obligations and internal policies. Personal data will be collected, stored and processed by J.P. Morgan Asset Management in accordance with our privacy policies at https://am.jpmorgan.com/global/privacy.

This communication is issued by the following entities:

In the United States, by J.P. Morgan Investment Management Inc. or J.P. Morgan Alternative Asset Management, Inc., both regulated by the Securities and Exchange Commission; in Latin America, for intended recipients' use only, by local J.P. Morgan entities, as the case may be. In Canada, for institutional clients' use only, by JPMorgan Asset Management (Canada) Inc., which is a registered Portfolio Manager and Exempt Market Dealer in all Canadian provinces and territories except the Yukon and is also registered as an Investment Fund Manager in British Columbia, Ontario, Quebec and Newfoundland and Labrador. In the United Kingdom, by JPMorgan Asset Management (UK) Limited, which is authorized and regulated by the Financial Conduct Authority; in other European jurisdictions, by JPMorgan Asset Management (Europe) S.à r.l. In Asia Pacific ("APAC"), by the following issuing entities and in the respective jurisdictions in which they are primarily regulated: JPMorgan Asset Management (Asia Pacific) Limited, or JPMorgan Funds (Asia) Limited, or JPMorgan Asset Management Real Assets (Asia) Limited, each of which is regulated by the Securities and Futures Commission of Hong Kong; JPMorgan Asset Management (Singapore) Limited (Co. Reg. No. 197601586K), this advertisement or publication has not been reviewed by the Monetary Authority of Singapore; JPMorgan Asset Management (Taiwan) Limited; JPMorgan Asset Management (Japan) Limited, which is a member of the Investment Trusts Association, Japan, the Japan Investment Advisers Association, Type II Financial Instruments Firms Association and the Japan Securities Dealers Association and is regulated by the Financial Services Agency (registration number "Kanto Local Finance Bureau (Financial Instruments Firm) No. 330"); in Australia, to wholesale clients only as defined in section 761A and 761G of the Corporations Act 2001 (Commonwealth), by JPMorgan Asset Management (Australia) Limited (ABN 55143832080) (AFSL 376919).

Malaysia, Philippines, Brunei, Thailand, Indonesia, India, Vietnam, Bhutan and Korea: This document is provided in response to your request. This document is for informational purposes only and does not constitute an invitation or offer to the public. This document including any other documents in connection are for intended recipients only and should not be distributed, caused to be distributed or circulated to the public. This document should not be treated as a prospectus or offering document and it has not be reviewed or approved by regulatory authorities in these jurisdictions. It is recipient's responsibility to obtain any regulatory approvals and complying with requirements applicable to them.

People's Republic of China: This document is private and confidential and is issued to you upon your specific request and is provided for your internal use and informational purposes only. It may not be photocopied, reproduced, circulated or otherwise distributed or redistributed to others. This document does not constitute an offer, whether by sale or subscription, in the People's Republic of China (the "PRC"). Any interests stated is not being offered or sold directly or indirectly in the PRC to or for the benefit of, legal or natural persons of the PRC. Further, no legal or natural persons of the PRC may directly or indirectly purchase any beneficial interest therein without obtaining all prior PRC's governmental approvals that are required, whether statutorily or otherwise. Persons who come into possession of this document are required by the issuer and its representatives to observe these restrictions.

For U.S. only: If you are a person with a disability and need additional support in viewing the material, please call us at 1-800-343-1113 for assistance.

Copyright 2021 JPMorgan Chase & Co. All rights reserved.

LV–JPM53186 | 04/21 | 0903c02a82b12ee9

J.P.Morgan
Asset Management