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Newsflash

Tariff implications for insurers

James Hewer
Senior Consultant
james.hewer@hymans.co.uk

Last week's US tariff announcements have stirred up market volatility, with equity markets in particular seeing large contractions. This volatility will have implications for insurers, but now may not be the time to rush into further hedging.

Insurer hedging programmes

Typically, life insurers use derivatives to hedge the market risks that they're most exposed to – this includes currency, interest rates and inflation risk*. Some, but not all, insurer shareholder portfolios are exposed to equity risk (for example, through the future income of management charges on unit linked policies or supporting with-profit funds capacity to pay bonuses with reduced reserves).

In times of extreme market volatility, often the first place firms' management will look to is hedging programmes. In particular, as market confidence weakens, management may be tempted to increase the amount of protection on the balance sheet by increasing hedge positions. There are circumstances when this would be an appropriate management action to take, for example, if Solvency was significantly threatened by further market movements

However, we argue that in a market crash and/or times of peak market volatility, it can be the worst time to increase the amount of balance sheet hedging, as you could be buying protection at its most expensive and locking in losses.

History shows that the strongest days of market returns are often in the weeks following a market crash. While there may still be further market movement in the coming days/weeks, any additional hedging put in place during the volatility would be notably more 'expensive' than existing hedges. Firms should weigh up the benefit of further downside protection against the potential economic costs of a recovery. Strategic hedging programmes should be set for the long term to cope with economic volatility such that risk appetites do not need to change during market events.

Other implications for life insurers

- Increased currency volatility: Its common for UK life insurers to have a large allocation towards US dollar investments and hedge the US dollar / GBP currency exposure. If the dollar strengthens against the pound, there would be liquidity implications from the associated margin calls on currency derivatives. While the textbooks may say the dollar would strengthen when US tariffs are increased (due to Americans importing less), there are other factors at play here which make the outcome highly uncertain.

- Sectoral credit spreads: The market volatility may present opportunities for investment managers, particularly in public credit, as the tariffs have strong sectoral implications. Localised spread widening may bring opportunities for firms, particularly those that have been holding off credit investment given the recent low spread environment.

**At the time of writing (7 April 2025), the majority of the market impacts of US tariffs mentioned are seen in equity and currency markets, with more limited impacts on interest rates and inflation.*

Risk warning: The value of investment can go up or down and neither is guaranteed. Past performance is not a reliable indicator of future results.

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