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Newsflash

Recent market volatility: what are the impacts on insurers?

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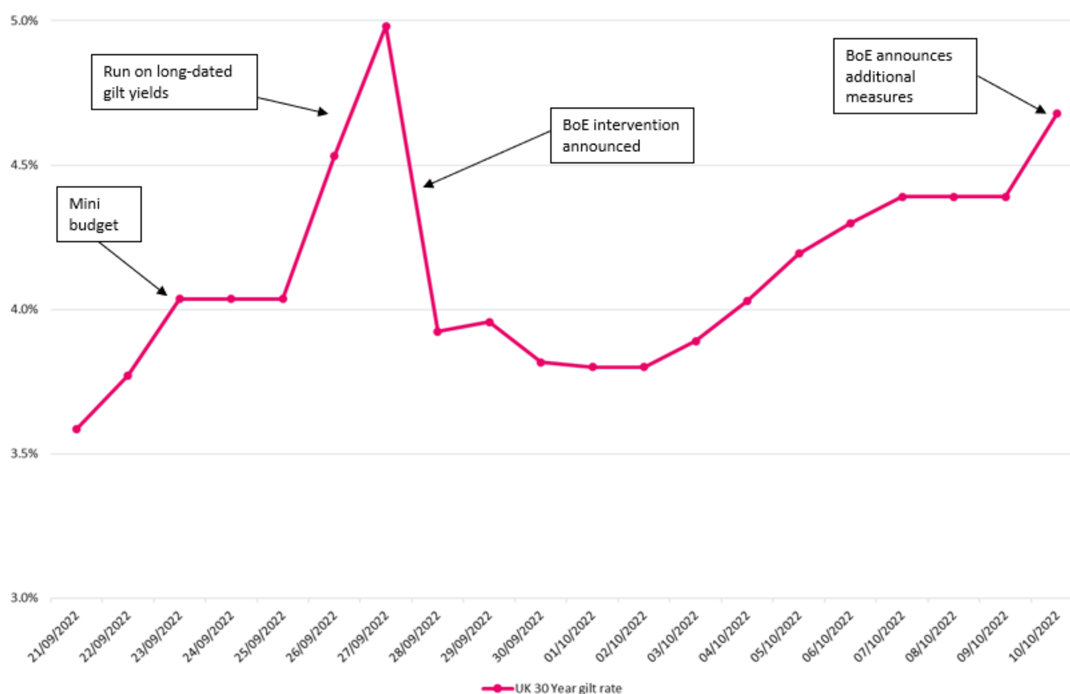
On Wednesday 28 September 2022, the Bank of England made an unprecedented intervention to prevent a run on long-dated gilts. Much of the ensuing analysis has concentrated on how the pensions market is faring, but what of the life insurance market?

What happened in the financial markets?



Source: Bloomberg

Gilt yields have been rising throughout 2022. However, in the days following the mini-budget, the price of long-dated UK gilts fell dramatically and the yield on 30 year gilts spiked by 1.2 percentage points over the subsequent 3 working days as markets responded to the significant unfunded fiscal stimulus.

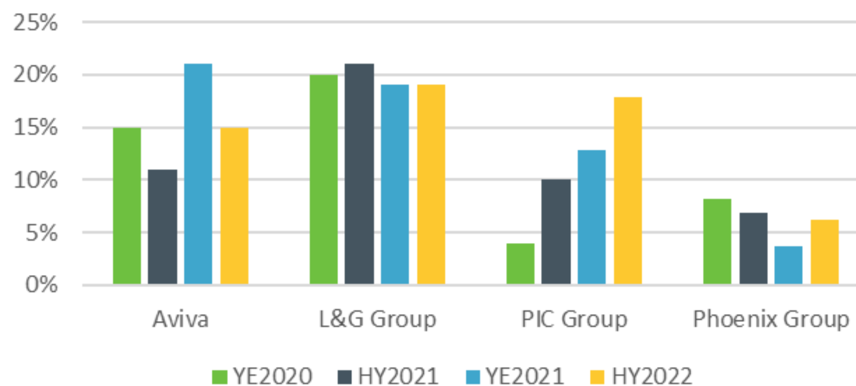
This unprecedented movement resulted in margin calls from pension schemes holding derivatives to protect their funding Bank of England (BoE) positions from falls in long-dated gilt yields. Many pension schemes sold gilts to meet the demands for cash or

posted gilts as margin - effectively putting these into the market. This exacerbated the issue, exerting further downward pressure on gilt prices and leading to even larger margin calls. A downward spiral had begun.

After 3 trading days, the BoE intervened. It postponed its active sale of gilts and committed to purchasing up to £5 billion of long-dated government bonds on each of the next 13 working days. The intervention led to a reduction in gilt yields, providing some short-term respite for pension funds.

So how are insurers affected?

Insurers appear to have navigated the volatile markets somewhat better than some pension schemes. A key difference was that insurers writing pensions business don't have leveraged gilt exposures and so didn't get the same size of margin calls as pension schemes and instead they typically hold physical assets that closely match the expected cashflows of their annuity liabilities. Insurers have also improved their liquidity management strategies following the PRA's policy statement PS 18/19.



While the solvency ratios of some insurers will have increased, depending on their sensitivity to gilt yields, the spike in 30 year gilt yields and the material movements in implied RPI, particularly on Wednesday morning before the BoE's intervention, when implied inflation fell c.80bps led to some significant margin calls.

The volatile market conditions had a negative impact on the price of insurance company shares and debt and while these had recovered slightly, at the time of writing, they had not yet returned to pre-budget levels. Some insurers issued communications to reassure their investors of the robustness of their businesses in response to the movements in the price of shares and debt.

Since the intervention, there have been trading opportunities with some trading of credit portfolios reported at prices lower than previously available. We expect to see some rebalancing of asset holdings in pension schemes and potentially reduced future demand for illiquid asset classes, which may provide insurers with the opportunity to acquire those assets at more attractive prices in the future.

Volatile market conditions make deal pricing more challenging for bulk annuity writers and the value of price-locks offered by some firms become increasingly valuable under volatile market conditions. However, we expect pension risk transfer services to be in even greater demand than previously as some pension schemes, especially those with improved funding positions, reflect upon recent events and decide to accelerate their derisking programmes. This is discussed in detail in our recent blog.

For insurers who invest in equity release and lifetime mortgages (LTMs), for new LTMs, an increase in gilt yields typically leads to a higher roll-up rate which increases the risk that the no-negative equity guarantee (NNEG) bites in future. In response, we may see some insurers retrench to lower loan to value limits to reduce the risk of the NNEG biting and to pass the PRA's Effective Value Test for which the deferment rate was recently increased. Higher rates may also mean less consumer demand in future.

Firms managing with-profits funds have a range of potential management actions available to help them navigate volatile markets as we discussed in our 2021 With Profits Report. We may see firms managing with-profits business considering whether their current bonus rates, Market Value Adjusters and smoothing approach continue to be appropriate as events play out.

What's next?

We expect to see insurers recalibrating their liquidity models and forward-looking stress scenarios to reflect recent severe events. Some firms may also revisit their liquidity risk management strategies and look to revise their collateral requirements to further increase credit assets which can be posted, as well as cash and gilts. We expect to see some firms revisit their view of asset-related risks, including the price risk on gilts, as well as interest and inflation calibrations, to satisfy themselves that their views align to true market risks ahead of year end.

We would be unsurprised to see new regulation in future aimed at reducing any identified systemic risks. For example, we expect there to be future restrictions imposed on the extent of leverage and collateral that pension schemes are allowed to use in future and this could be implemented either through a new DB funding code or through regulation of LDI managers. It's important there is engagement with any proposed regulation to ensure it is appropriate for the insurance industry.

How can we help?

Hymans Robertson's Insurance and Financial Services team offers expertise in all areas of actuarial and risk management and have specialists who have advised on liquidity risk assessments, ALM strategies and recovery and resolution planning. Our wider team offers senior actuaries in risk and capital, insurance ALM, longevity, products and digital and Property & Casualty.

If you are interested in any of these topics and would like to discuss them, please contact **Dan Diggins** or **Nicola Kenyon** in the first instance.

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