SPECTRUM
Asset Management

Insurers Resilient to UK Market Turmoil

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Global central bank tightening has tested market liquidity. During the week of September 26th, the UK pound collapsed, and 30-year gilt yields temporarily spiked to over 5% from below 4% a week earlier. The market's rapid adverse response to fiscal plans proposed by the new UK government triggered cash margin calls on leveraged derivative positions used by the ~£1.5 trillion UK liability driven investment (LDI) market to manage underfunded pension plans. Forced asset liquidations to satisfy these calls perpetuated the market collapse and the Bank of England was forced to step in and may continue to do so. UK life insurance stocks traded down significantly, being major participants in the UK pension market – both through annuity offerings and LDI in some asset management segments – and given concerns regarding UK risks in their investment portfolios. **LDI liquidity risks are <u>not</u> those of insurers, but of pension clients for whom asset managers act as agent.**

Also, pension annuities held on UK life insurance balance sheets differ from LDI backed plans, and insurers are well positioned to withstand market stresses given strong regulation and risk management:

- UK insurers tend to take on fully funded pensions in their annuity businesses, lessening hedging risks
- Where they hedge, insurers are often able to pledge assets rather than needing to raise cash as collateral
- European Solvency 2 regulation holds insurers to rigorous 1-in-200-year stresses supporting robust capital & liquidity requirements
- Solvency 2 capital on average is >2x requirements and resilient to various stress scenarios
- Insurers broadly invest in investment grade fixed income as well as other higher-quality assets, including mortgages and direct investments
- Rising rates are generally favorable as insurers are mainly long-term investors and market moves are thus less meaningful than realized losses

While we do not view recent market volatility as a significant capital or liquidity concern for insurers, there could be reputational implications for those managing LDI strategies. Importantly, insurers have been adept at navigating difficult periods such as the GFC and COVID-19 and broadly remained supportive of capital providers, including preferred and junior subordinated investors.

Spectrum believes insurers should continue to be underpinned by strong capital, good liquidity and sound investment portfolios, despite macro uncertainty.

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