

فراخوان ترجمه کتاب

پژوهشکده بیمه، به منظور کمک به گسترش دانش بیمه‌ای، ترجمه کتاب

Sustainable Life Insurance: Managing Risk Appetite for Insurance Savings and Retirement Products

را در دستور کار خود قرار داده است. لذا از کلیه اساتید، پژوهشگران، صاحب‌نظران و کارشناسان دعوت می‌شود که در صورت تمایل به ترجمه کتاب مذکور، کاربرگ درخواست ترجمه پیوست را به همراه سوابق علمی و اجرایی خود و ترجمه صفحات ذکر شده با ذکر عنوان کتاب، حداکثر تا تاریخ ۱۴۰۲/۰۶/۱۵ به آدرس ایمیل nashr@irc.ac.ir ارسال فرمایند.



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ردیف	محل خدمت	مدت زمان خدمت

Designing Products Aligned with the Risk Appetite for Sustainable Savings and Retirement

THE COMBINATION OF DECLINING pensions and flagging state healthcare spending is forcing more Europeans to look for additional or alternative retirement funds. This confluence of circumstances produces a tremendous demand for protected saving solutions in the mass market. In general, demand for such guaranteed products has been highest among lower- and middle-income brackets, while individuals in higher-income brackets have indicated more willingness to invest in products with no protection but a higher upside potential.

Across all lines of business, there is increased demand for more affordable, transparent and customized insurance that better suits the evolving conditions and can be easily adjusted as the needs change. The new needs and expectations regarding financial wellness have translated into drastic and rapid shifts in risk appetite on the part of individuals, in terms of (i) ensuring suitable and sustainable behaviour in the use of their savings and retirement products, such as surrender, withdrawals and annuitization, becomes more “efficient” throughout a “multi-stage” life and (ii) a demand for more sustainable investments in assets, as illustrated by the significant growth in their environmental, social and governance scores.

These significant changes in customers’ risk appetite and associated saving behaviour have further strengthened within the context of (i) declining and persistently low interest rates over the past decade, driven by the jump in central banks’ balance sheets, and (ii) new regulatory prudential required capital (RC), accounting and consumer protection frameworks, which tend to increase not just long-term safety but also short-term costs.

As a result, life insurers have had to further expand their value propositions and product sets to address all aspects of financial wellness, centring customer experiences and streamlining their journey as a priority. Life insurers must respond to customer needs and expectations around flexibility, personalization and relevance. In this respect, life insurers have improved the sustainability of both their liabilities and their investment assets.

Regarding liabilities, section 1 illustrates how life insurers can screen sustainable saving and retirement product opportunities, balancing shareholders’ versus customers’ risk appetites, through capital intensity and customer-centric metrics. Section 2 then focuses on how to improve the solvency IRR through product designs, mitigate customer behaviour risk and enhance the customer experience by tailoring the product design and reconcile insurer and customer risk appetites through sustainable capital-light products (low capital requirements while offering capital protection and an upside potential).

Regarding the assets side, section 3 focuses on why life insurers are also eager to move into asset management as a capital-light business. They hope to lighten their capital burden; however, this change also puts

insurers in direct competition with private equity and asset managers who have a significant competitive advantage in this area and often operate at lower costs. Among the key sustainable innovations reconciling insurer and customer risk appetites are (i) the improved risk management of fund management, (ii) enhanced performance in asset selection and allocation while meeting the growing demand for ESG assets and (iii) optimized portfolio rebalancing, allowing for a lowering of transaction costs and financial risks alike.

4.1 SCREENING SUSTAINABLE OPPORTUNITIES BALANCING SHAREHOLDERS' VERSUS CUSTOMERS' INTERESTS WITH PERSISTENTLY LOW RATES AND GROWING REGULATORY CONSTRAINTS

4.1.1 The Impact of a Prolonged Low Interest Rate Environment

The interest rate environment has a significant impact on many segments of the financial sector, including the life insurance industry. Interest rates declined significantly following the 2008 global financial crisis before levelling out at historically low rates, which persisted even with monetary policy normalization efforts by the Fed beginning in 2015. Interest rates then fell precipitously further at the beginning of the Covid-19 pandemic, with the yield on the benchmark ten-year Treasury (constant maturity) dropping to an unprecedented low of 0.6%. In mid-2021 interest rates returned to near-pre-pandemic levels, but those levels were at 50-year lows. They rose further with the emergence of significant inflation, further fuelled by the war in Ukraine, not experienced since the beginning of the 1980s, although they have remained significantly below the average historical level.

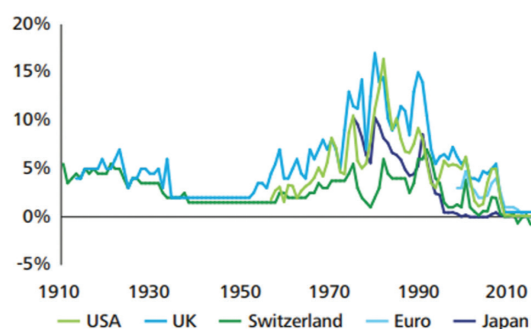


FIGURE 4.1 Overnight rates from central banks over the past century, 1910–2020

Central banks use a variety of tools to fulfil their dual mandate of maximum employment and stable prices. Their primary policy instrument is open market operations, which is the buying and selling of short-term Treasury securities to keep the designated interest rate within its target range. Historically, central banks raised their target when the economic outlook was inflationary and lowered the target rate or range when the economy was soft or in a downturn, such as during a recession. In an effort to support the economy and financial markets during the financial crisis and 2007–2009 Great Recession, central banks dramatically lowered the target to nearly 0%, then began using unconventional monetary policy instruments, including the large-scale purchases of long-duration Treasury securities and agency mortgage-backed securities (a quantitative easing [QE] programme).

Such a persistently low interest rate environment is a key concern for life insurers, because their assets and liabilities are heavily exposed to interest rate movements, across the four dimensions of the risk appetite (earnings, value, capital, liquidity).

4.1.1.1 Earnings Impacts

The average return on equity for insurers has fallen significantly, notably in Europe, from around 11% in 2014 to about 9% in recent years.

In particular, their investments are concentrated (80%) in fixed-income securities that return interest, largely bonds, and are then repackaged into annuities and life insurance products that reflect the yields of the underlying investments. When interest rates increase, therefore, the opportunity cost of holding bonds at a lower rate over time also increases.

Moreover, their liabilities are also sensitive to interest rates. Specifically, many of their products, such as annuities, have a guaranteed rate of return, usually in the form of interest that is credited. Life insurers' earnings mostly are derived from the spread between their investment returns, which are mainly interest, and what they credit as interest on these consumer products. During times of persistently low interest rates the spread between interest earned and interest credited is compressed, which not only reduces net income for the insurers but also puts them at risk of being unable to meet contractually guaranteed obligations to policyholders.

Many insurers' earnings on in-force blocks have come under pressure, as guaranteed rates to policyholders are still as high as 150 to 400 bps in some markets, while yields on bonds have declined by 150 to 300 bps since 2010/11. Naturally, this has strained capital, as insurers have had to adjust their reserves to reflect future earnings expectations. Specifically, the spread fell from 1.8% in 2007 to 1.15% in 2009 in the United States, then remained historically low, until plummeting from 2018 to 2020 (reaching 0.63%).

Even in the event of rising rates in the coming months and years, carrier investment portfolios tend to lag behind movements in the market by several years, due to the various durations of the bonds that make up investment portfolios. Besides, most life insurance products with declared dividends or crediting rates assume that the current market environment stays constant for the life of the policy, as regulatory restrictions preclude the use of earning rates higher than what is currently being credited.

Historical analysis shows that the overall trend is for the profitability of the insurance sector to increase in an environment of rising interest rates. Overall price-to-earnings (P/E) ratios for insurance company stocks usually increase in fairly direct proportion to increases in rates.

4.1.1.2 Value Impacts

Changing interest rates also affect insurers through portfolio revaluation effects. Falling interest rates increase the value of existing interest-earning assets in the life insurers' portfolios (from about \$3.6 trillion to \$3.9 trillion in the 2020s, as against \$2 trillion in 2006), in particular the long-term bonds massively held by insurers.

Further, life insurers typically hold bonds to maturity, because of the need to match the timing of asset returns and policyholder claims, so therefore the capital gains typically are not realized. Moreover, when a low interest rate environment persists, higher-yielding assets mature and must be replaced by low-yielding assets. An average insurance company reinvests about 12% of its assets annually, so this profitability challenge becomes increasingly acute every year.

If the first risk in a low interest rate environment is to be forced to invest at too low yields, the second risk is to face a sudden increase in interest rate; clients are likely to let their contract lapse so as to take a new opportunity with higher rates. Thus, persistently low interest rates may also affect customers' behaviour; in particular, one of the general account's complexities is predicting and managing policyholder behaviour, either lapsing earlier than scheduled or sticking longer than expected, which impacts the insurance balance sheet duration.

- In a low rate environment, benefiting from higher guaranteed rates, policyholders keep or even increase their savings -> duration increases.
- In a rising rate environment, policyholders can use their option to lapse and invest in other higher-yielding products -> duration decreases.

As a result, such changes in behaviour imply negative feedback effects on interest rate risks for the insurer.

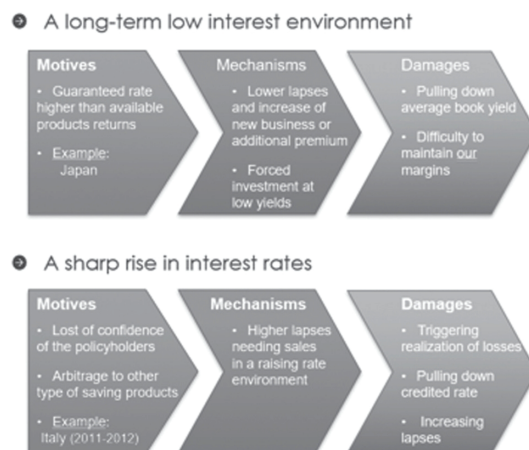


FIGURE 4.2 Impact of interest rates on lapses

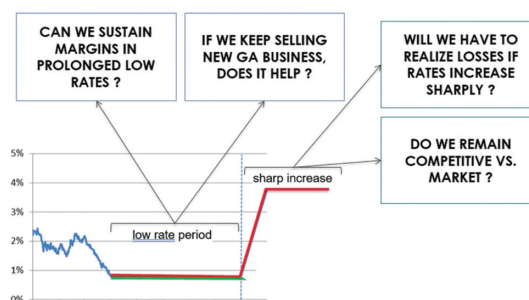


FIGURE 4.3 Rates move versus earnings

Another challenge lies in new business value: as interest rates fall the overall willingness of people to enter into long-term insurance contracts declines, since customers are less willing to potentially lock their money and their future premiums into contracts offering an expected low return. Most customers drift to alternative investment approaches, such as short-term savings vehicles (the “wait and see” approach) or directly invest in other asset classes, such as real estate. Thus, insurers’ new business volumes progressively come under pressure. This is more apparent in traditional insurance markets that have historically favoured bond investments to back policyholder liabilities.

Last but not least, there is the value proposition: most markets still want insurance guarantees even though returns on traditional products are less than zero after the deduction of underlying costs. Consequently, providing insurance products that include guarantees by simultaneously offering the potential for attractive returns is impossible. The majority of European insurers are today unable to price new guaranteed investment products at competitive rates. In addition, the higher capital charges under Solvency II for investments other than government bonds add to this dilemma.

4.1.1.3 Capital Impacts

The fall in interest rates does not improve the insurers’ statutory capital position, because the bonds are reported at book value: in 2014 Swiss life insurance companies had to use over 50% of the total operating result to strengthen their solvency capital.

As a matter of fact, in the past few years the cost of capital for insurers has climbed far more rapidly than it has for other industries. As a result, capital has to be managed more efficiently in order to deliver higher returns. Indeed, any recalculation of the technical provisions to reflect interest rate movements will result in a stronger drag on an insurer's capital generation as it is subsequently amortized.

However, these can reinforce one another and result in a vicious cycle: pressure on solvency ratios can force insurers to move out of higher-yielding asset classes that attract higher capital charges in order to improve the solvency ratio, and, while the “de-risking” provides a short-term improvement, ultimately it further deteriorates firms' ability to generate capital/cash. Financial revenues will decline across products, the capital requirements of guarantees will skyrocket and the value proposition of life insurers in savings products will be increasingly questioned.

Moreover, local reserving rules that include a “smoothing” element to avoid spurious volatility (e.g. by looking at historic interest rates over a long time horizon) are now fully based on a low interest rate environment.

For example, in Germany the Zinszusatzreserve (ZZR), introduced in 2011, brought in an additional reserve whenever the cost of a guarantee offered by a life insurer is higher than a “reference rate”. This additional reserve is based on the average of the previous ten years of swap rates – i.e. on the past ten years of low and decreasing rates – which means that it will effectively “lock in” the effect of the current environment even after rate changes, thus forcing many firms to realize additional reserves, further compromising capital generation ability in the long term. Furthermore, German statutory reporting is likely to exacerbate the economic pressure, as life insurers have to sell the high-yielding assets in order to fund the growing ZZR requirement (introduced in 2011 and expected to reach a total of €160 billion by 2030, or more than 10% of total life insurance reserves) and reinvest them into lower-yield assets.

4.1.1.4 Liquidity Impacts

Persistently low interest rates can finally affect life insurers' liquidity. Liquidity is the ease with which assets can be converted to cash. Liquidity management is critical for life insurers. As part of asset liability management (ALM), life companies strive to match asset cash flows with cash outflows to avoid asset–liability mismatch and interest rate risk. During periods of low interest rates, cash flows from assets and liabilities can be badly mismatched, exposing insurers to losses from potentially pressured asset sales to meet current obligations to policyholders. At the same time, under conditions of persistently low interest rates liquidity demands tend to decrease, as policyholders are more likely to keep their money in life insurance investment products, such as annuities, due to the previously agreed and guaranteed return and limited availability of higher-yielding alternatives. On the flip side, as interest rates rise, interest-earning policies are increasingly likely to lapse.

Insurers thus face a dilemma. Their traditional business model no longer works in a negative rate environment. Guaranteed insurance products that provide simple retirement income are unsustainable, and the situation becomes even more acute under current solvency regulations (specifically, the European and new US NAIC frameworks, to some extent). Companies' own returns on capital and price-to-book ratios are nearly at all-time lows. At the same time, customers are clamouring for new answers as they are forced to invest in a low-yield, high-volatility environment and take on the longevity risk themselves. Insurers can resolve this dilemma for themselves and their customers, but bold action is required.