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Financial Cycle Perspective on the Transformation and Development of Insurance Asset Management Industry

Hai pei Huang

Abstract: In recent years, with the deepening of the integration of global financial markets, the rapid development of financial technology and the continuous evolution of regulatory policies, the insurance asset management industry is facing unprecedented challenges and opportunities. At the same time, the ups and downs of the financial cycle are also testing the risk management ability of the insurance asset management industry. From the perspective of financial cycle, this paper deeply analyzes the impact of financial cycle on the insurance asset management industry, and then explores its transformation and development path.

Keywords: Financial Cycle; Insurance Asset Management; Asset Liability Management

In the wave of globalization and economic integration, the volatility and uncertainty of the financial market are increasing, and the changes of the financial cycle have a profound impact on all walks of life, especially the financial service industry. From the perspective of the financial cycle, the insurance asset management industry is standing at a critical turning point. On the one hand, the depth and breadth of the financial market continue to expand, providing more investment opportunities and risk management tools for the insurance asset management industry; On the other hand, the volatility and complexity of the financial cycle also put forward higher requirements for the investment strategy, risk management and operation model of the insurance asset management industry. Therefore, it is necessary to study the transformation and development strategy of insurance asset management industry from the perspective of financial cycle.

1. Measurement of financial cycles

The measurement of the financial cycle is a vital tool for understanding macroeconomic fluctuations and financial system stability. It is commonly perceived that the financial cycle manifests through fluctuations in credit and asset prices, particularly real estate prices, with a duration spanning around 15-20 years, transcending traditional business cycles. Researchers typically focus on three core indicators when measuring the financial cycle: actual credit growth, the ratio of credit to GDP, and actual real estate prices. These indicators reflect the expansion and contraction of financial activities. Credit, as a barometer of fund supply, is closely tied to economic activity, especially in scenarios where information asymmetry and bank balance sheet maturity mismatches amplify economic fluctuations.

2. Characteristics of China's financial cycle

China's financial cycle is characterized by significant long-term volatility, with key indicators including credit, real estate prices, and credit /GDP ratios, which move in tandem to reveal the expansion and contraction cycles of financial activity. At present, China is experiencing a downward phase of the financial cycle, which is manifested by a slowdown in credit growth, a correction in property market prices, and a adjustment in the leverage ratio of the real economy. Although credit and real estate prices are driven by different factors, they will intensify the negative impact of the financial cycle and lead to tighter credit conditions. Historically, China has completed two cycles of approximately 15-year cycles and is currently in the early stages of a new downward cycle, which is expected to last 3-5 years. Financial and business cycles interact significantly, with downward cycles often associated with deeper recessions and upward cycles promoting stronger economic growth.

3. The impact of financial cycle on the insurance asset management industry

3.1 Impact on Insurance Asset Management from the Asset-side Perspective

From an asset-side perspective, the evolution of the financial cycle has profound implications for the insurance asset management industry, particularly pronounced during the downturn phase of the cycle. Under the combined influence of economic fundamentals, credit environment, and interest rate changes, insurance asset managers must flexibly adjust their investment strategies to cope with challenges and seize potential opportunities. On one hand, slowing economic growth leads to a general decrease in asset returns, highlighting the scarcity of high-quality assets. During the latter half of the financial cycle, the deleveraging process weakens economic growth momentum, causing corporate profits and capital return rates to decline. For insurance asset managers, this implies lower yields from traditional investment channels and intensified competition for quality assets. On the other hand, rising credit risk alongside a declining interest rate trend complicates asset management. A tightening credit environment not only increases the risk of default but may also lead to value depreciation in assets leveraged heavily, further impacting overall economic activity.

3.2 Impact on Insurance Asset Management from the Liability-side Perspective

From the liability-side perspective, the evolution of the financial cycle exerts complex and far-reaching influences on the insurance asset management industry, primarily manifesting in two dimensions: the rigidity of liability costs and increased industry segmentation, along with adjustments in the liability structure and changes in the competitiveness of insurance products. During the downturn phase of the financial cycle, the cost of liabilities for insurance funds demonstrates strong rigidity, with a delayed response to interest rate changes. In a low-interest-rate environment, although asset yields fall in tandem, the interest rates of insurance products adjust relatively slowly, leading to an "asset shortage" issue for insurance asset allocation, where it becomes challenging to find assets with sufficient returns to cover higher liability costs.

With the adjustment of financial regulatory policies, such as the implementation of the New Asset Management Regulations, the debt-side structure of the insurance industry is also undergoing profound transformation. The past model of rapid expansion relying on short-term high-cost funding (such as universal insurance) is not sustainable, and the strengthening of regulation has encouraged the insurance industry to return to its roots and encourage the development of long-term, robust insurance products. Although some insurance companies may face liquidity pressure and business adjustment pains in the short term, in the long run, this is conducive to the overall healthy development of the insurance industry [2].

4. Transformation and development of insurance asset management industry from the perspective of financial cycle

4.1 Reshape the balance sheet management strategy to cope with the challenge of low interest rates

Firstly, insurance asset management companies need to strengthen dynamic asset-liability management capabilities, utilizing sophisticated interest rate sensitivity analysis and cash flow matching techniques to optimize asset allocation and ensure that asset returns can cover liability costs in a low-interest-rate environment. This necessitates designing more flexible product structures on the liability side, such as developing floating-rate insurance products or introducing mechanisms linked to market interest rates to mitigate the direct impact of interest rate changes on liability costs. On the asset side, insurance asset managers should broaden their investment horizons, exploring diverse investment channels, including increased allocations to alternative investments (e.g., infrastructure projects, private equity, real estate), and moderately raising the proportion of overseas assets, leveraging global asset diversification to manage investment risks and seek higher potential returns.

Secondly, deepening the application of technology in asset-liability management, leveraging big data, AI, and other modern technologies to enhance risk management precision and efficiency. Developing scenario-based asset-liability management systems to prospectively predict asset returns and liability costs under different future economic and financial conditions fosters dynamic optimization and rebalancing of assets and liabilities. Concurrently, enhancing the analysis of interest rate trends and utilizing quantitative models to support decision-making, capturing subtle market changes, and promptly adjusting investment strategies to seize market opportunities.

Additionally, the industry should reinforce the duration matching of assets and liabilities, issuing long-term insurance products or designing innovative insurance liability structures to extend liability durations, aligning with the investment cycles of long-term assets and reducing reinvestment risk. Based on this, establishing a rigorous liquidity risk management framework ensures the company's financial stability when market liquidity is tight, enabling effective management of maturing debts and fulfillment of claims obligations.

4.2 Accelerate digital transformation and technological innovation to improve the efficiency of investment decision-making

The core of digital transformation is the use of big data, cloud computing, artificial intelligence and other cutting-edge technologies, deep mining and analysis of massive data, to build intelligent investment decision support system. For example, the algorithm model can predict the trend of interest rate changes, arrange asset allocation in advance, or use natural language processing technology to analyze market news and social media sentiment to assist in judging the market trend and improve the foresight and accuracy of decision making. In addition, we build a customer data analysis platform, deeply understand customer needs and behavior patterns, customize personalized insurance and asset management solutions, enhance customer stickiness and satisfaction, and open up new growth points for insurance asset management companies.

Scientific and technological innovation is not only the key to improve internal management efficiency, but also an important driving force to promote the innovation of insurance asset management products and services. Companies can use blockchain technology to enhance transaction transparency and security, simplify transaction processes, reduce operational risks, and provide a more efficient and secure trading platform for the use of insurance funds. In this process, combined with the Internet of Things (IoT) technology, insurance asset management companies can develop innovative insurance products linked to the performance of physical assets, such as smart health insurance and property insurance based on iot device monitoring, achieve dynamic pricing and management of risks, and open up new markets for cross-border integration.

Conclusion: To sum up, the volatility of the financial cycle is both a challenge and a catalyst for the transformation of the insurance asset management industry. In the face of the low interest rate environment under the new normal of the economy, the change of credit risk, and the increase of interest rate volatility, the insurance asset management industry must actively embrace the change, and stabilize and enhance its market competitiveness through a series of strategic adjustments and innovative development.

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