

Investment News

Monthly Bulletin from the Insurance & Investment Team

June 2017

Last Month in Brief

The snap general election and upcoming Brexit negotiations have contributed to the pound fluctuating in recent weeks. Sterling suffered from significant volatility in the month, falling to \$1.278, before ending the month roughly flat. The pound also suffered falls against the euro. The FTSE 100 subsequently rose 4% to 7,512 over the month, which can be partly attributed to the weakened pound.

The US economy grew faster than expected during the first quarter of the year, with revised GDP growth at an annualised 1.2% compared to a 0.9% rise as predicted by Bloomberg. This figure represents a slowdown from the final quarter of 2016, when annualised GDP growth was 2.1%. Consumer spending improved in the first quarter, but growth remained slow at 0.6%. Job growth in the US was also lower than expectations, with 138,000 jobs added in May compared to Wall Street estimates of 182,000.

Inflation in the Eurozone has fallen from 1.9% in April to 1.4% in May, according to data from the European Commission's statistics agency. This is below the European Central Bank's inflation target of just under 2%, which will ease pressure to wind down its quantitative easing programme, in which €60 billion of bonds are bought each month to help economic recovery. Unemployment in the Eurozone fell from 9.4% to 9.3%, which is its lowest level since March 2009.

Chart 1: Equity Indices

Equity markets rose over the month

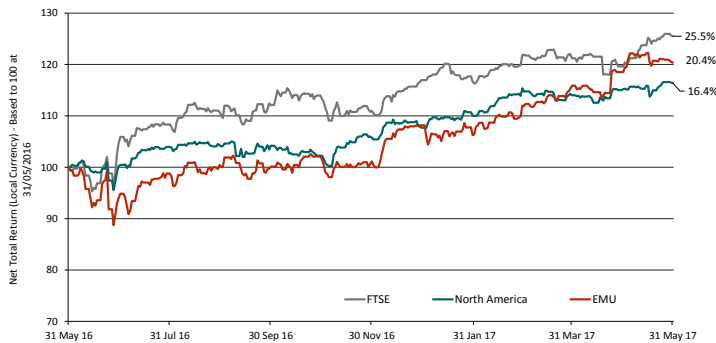


Chart 2: Sterling Credit Spreads

Credit spreads were stable over the month

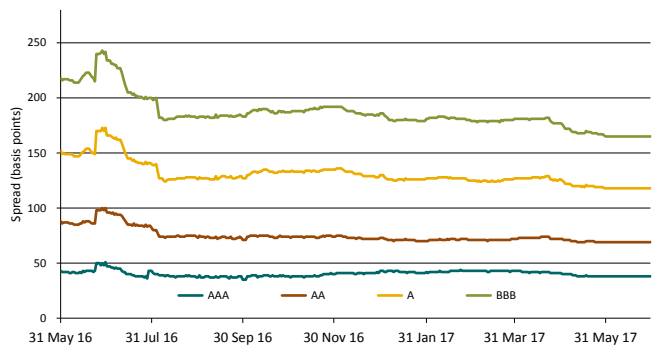
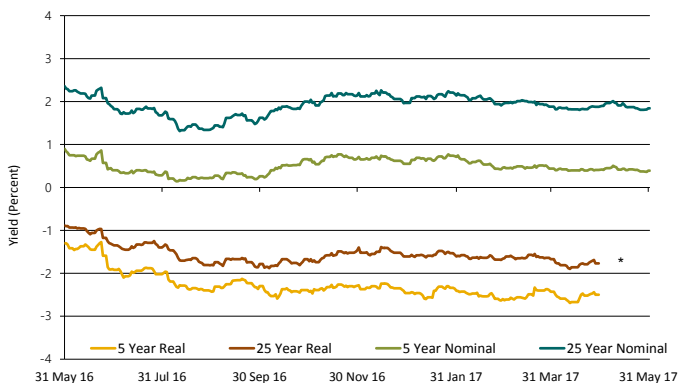


Chart 3: Gilt Yields

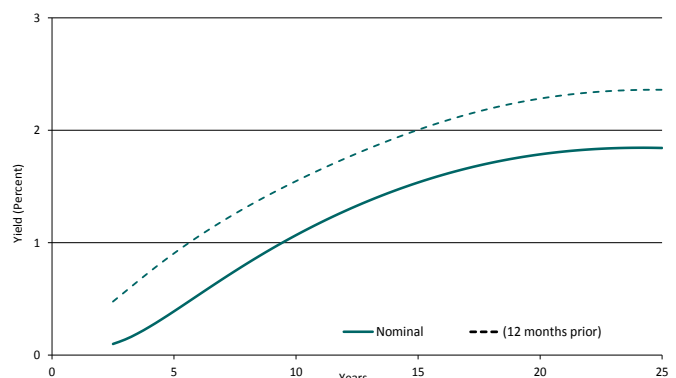
Nominal gilt yields were stable over the month



* Data for real gilt yields is temporarily unavailable from the Bank of England

Chart 4: Gilt Spot Curves

The yield curve remains upward sloping



Source: Financial Times, MSCI, Merrill Lynch Bank of America and Bank of England. Note real gilt yields are not displayed this month as their calculation methodology is under review.

	Latest	Previous		Latest	Previous
CPI (annual change)	+2.7%	+2.3%	Base rate	0.25%	0.25%
PPF 7800 funding ratio	86.0%	87.0%	\$/£ exchange rate	1.29	1.29
Halifax house prices (monthly change)	+0.4%	-0.1%	VIX (volatility) index	10.41	10.82

Cyber security and insurance

Last month, a piece of malicious software (malware) known as WannaCry spread across the internet, infecting 300,000 computers worldwide and causing disruption to Britain's National Health Service, Russia's interior ministry and various companies. The attack on the NHS affected thousands of computers, and demanded that users pay £230 to have files restored, leaving hospitals and GPs with no access to patient data. Cyber attacks such as this are becoming more significant and common.

What is cyber security?

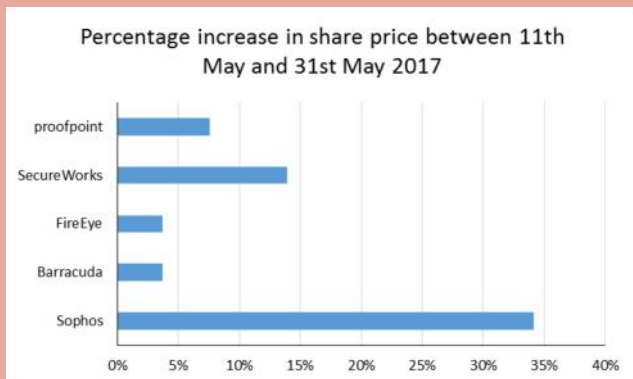
Cyber security is the protection of computers, programs and data from unauthorised access. Companies, other institutions and governments maintain and share increasing amount of confidential information using computers, meaning that data is vulnerable to cyber attacks. Cyber security platforms work to prevent, detect, reduce and resolve these vulnerabilities.

The growth in cyber security is primarily driven by the necessary measures needed to counteract the increasing number of cyber crimes that people, businesses, and governments face on a daily basis. Cyber criminals are continually innovating: Stuxnet is seen as one of the first cyber weapons. It is a computer virus that attacks widely used industrial control systems, and its techniques are now widespread. Further significant developments have happened when governments and other organisations around the world have had their cyber espionage techniques leaked.

In response to the increasing threat, new techniques are constantly being developed in cyber security, including tapping into artificial intelligence and machine learning techniques. Companies are also beginning to use quantum computing techniques as the speed of response to attacks is key to fending them off.

Figure 1: WannaCry impact on cyber security stock prices

Data Source: Bloomberg



After the WannaCry attack, 34 of the 39 equities within a cyber security exchange traded fund (HACK) advanced. That these firms saw share price rises, instead of falls, after an attack demonstrates that markets believe that companies will be ramping up their cyber security spending in future.

Industry outlook for cyber security

It has been reported that in 2016 4.2bn records were exposed internationally in more than 4,000 security breaches. These breaches revealed sensitive personal information such as email addresses, credit card information and medical data. In response to

this, International Data Corporation, a US market research company, forecasts that \$100bn will be spent by businesses on cyber security in 2020, up from \$74bn in 2016. The number of cyber security venture deals is also growing, with venture capital firms investing around \$8bn into cyber security companies since 2014.

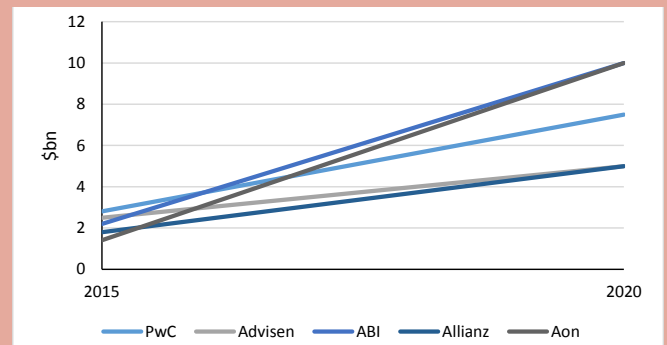
This increased spending has led to rapidly growing valuations for some cyber security start-ups. CrowdStrike, founded in 2011, has recently raised \$100m and is valued at over \$1bn. George Kurtz, the company's chief executive, said that CrowdStrike had received a surge in requests for trials as the WannaCry ransomware infected computers around the world.

Cyber insurance

Companies have increasingly started to turn to insurance companies to cover losses caused by digital means, rather than the physical losses that are traditionally covered. Cyber insurance, according to the Association of British Insurers, covers the losses relating to damage to, or loss of information from, IT systems and networks.

The cyber insurance industry is forecast to experience rapid growth (see figure 2). However, there are a number of challenges which face the industry. As cyber attacks are a relatively recent phenomenon, growth is hampered by a lack of information upon which insurers' can assess the risks of providing insurance. This information is vital for insurance companies as it allows them to price

Figure 2: Estimated cyber insurance premiums by selected organisations. Data Source: Financial Times, Companies, Swiss Re



their cover and calculate the reserves they need to hold to cover claims. If this data is unavailable, insurance companies will be unable to offer this cover.

Furthermore, the techniques and targets involved in cyber attacks are constantly developing, meaning that past information becomes increasingly less relevant. This exacerbates the problems of limited information. Finally, organisations struggle to fully understand the cyber risks they face, so may not take sufficient action to prevent the attacks nor purchase sufficient insurance cover.

Cyber insurance is also a concern for Government, as it could be a risk to UK plc as a whole. If widespread cyber attacks were launched against the UK, this might have a substantial impact on the Government, and therefore UK taxpayers. Attacks could have a large negative influence on incomes, public safety and quality of life for those in the UK. For more information on this topic, see John Plevin's article in Issue 27 of eNews from GAD: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/600850/GAD_E-news_issue_27_Mar_2017.pdf

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