Institute and Faculty of Actuaries

Risk and Investments Conference

Eugene Dimitriou

5 June 2015

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Biography

Eugene Dimitriou

Mr. Dimitriou is a senior vice president and account manager within PIMCO's financial institutions group in the London office, focusing on business development. He leads PIMCO's Solvency II working group in preparation for the new insurance regulations. Prior to joining PIMCO in 2013, he was a managing director in Royal Bank of Canada's financial institutions group, advising insurance companies on asset/liability management, structured finance, risk management and investment strategy. Mr. Dimitriou has also held senior positions at Royal Bank of Scotland, Morgan Stanley and William Mercer. He has 20 years of investment experience and holds an MBA from the Stern School of Business (NYU) as well as an undergraduate degree from the University of Waterloo in Waterloo, Canada. He is a Fellow of the Society of Actuaries (FSA).

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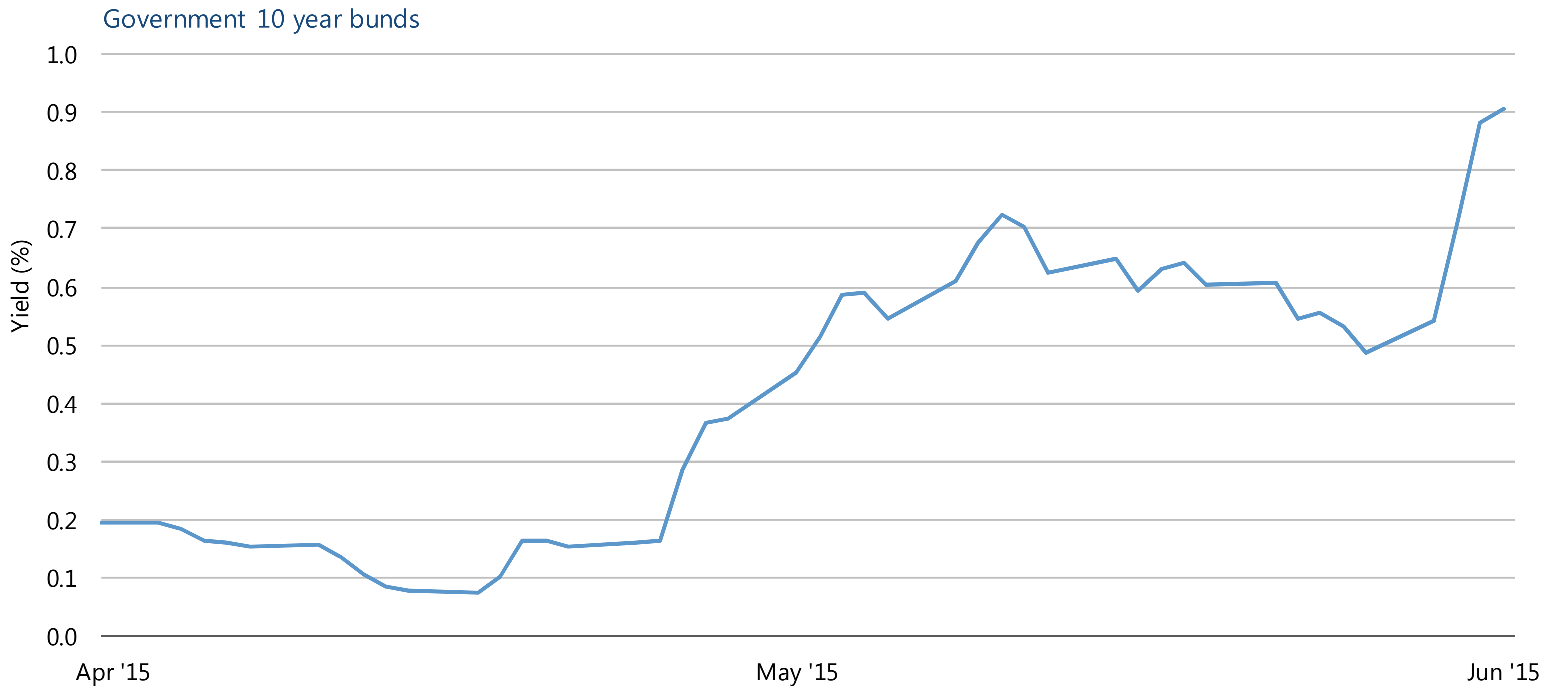
Stop the press: Are euro yields rising?



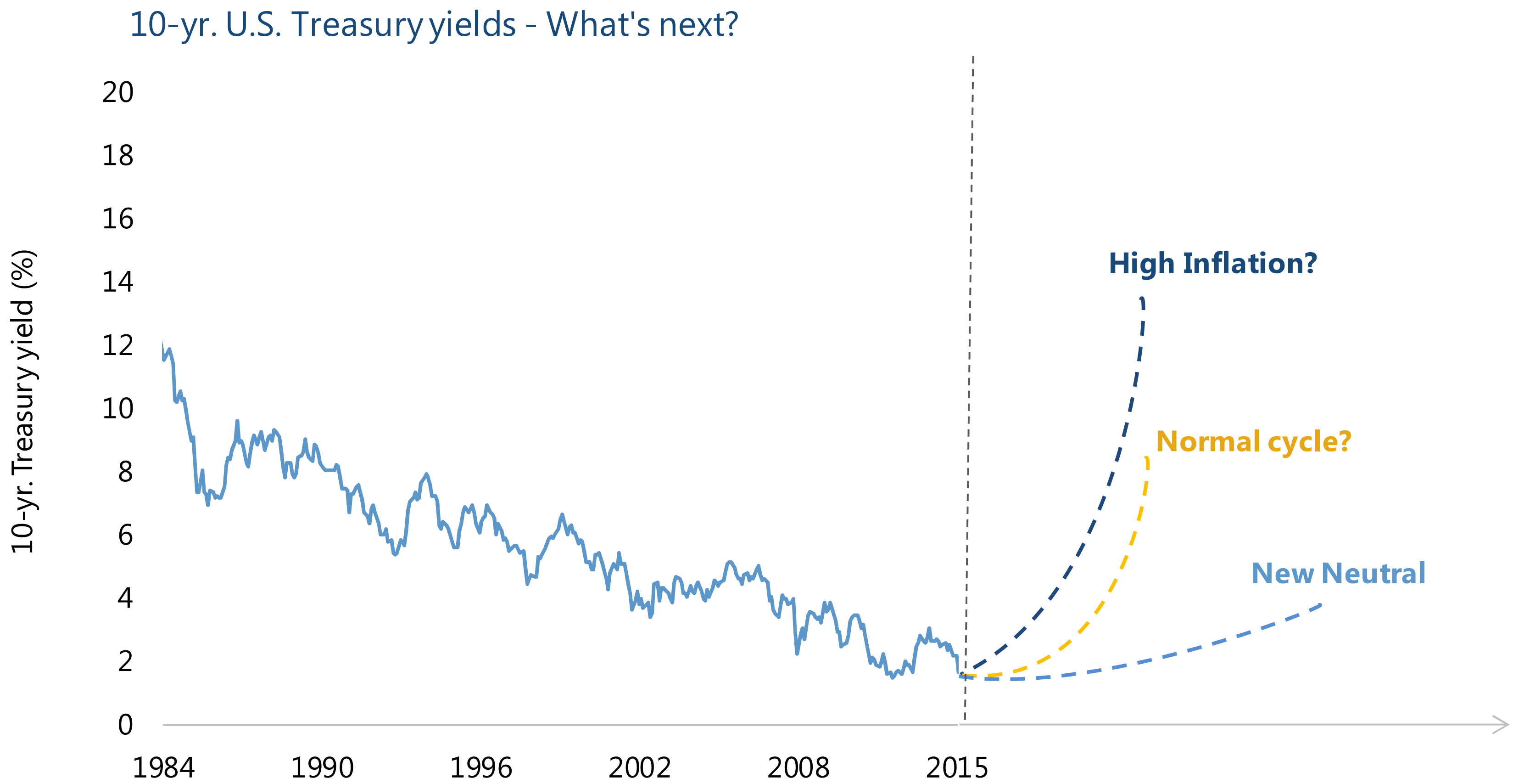
"A protracted period of very low interest rates [...] causes problems for insurance companies and other important financial market actors. Is this a good reason to change our monetary policy? The answer is no". "The second issue is typical of insurance companies. Clearly, the insurance companies try to respond to this situation in a variety of ways, which I don't want to discuss, because some of them have to do with their business models, but certainly it's quite clear that certain regulatory provisions make their task of diversifying their investments into higher yield and potentially more liquid investments more difficult."

Mario Draghi, *ECB conference 3 June 2015*

As of June 2015
SOURCE: Bloomberg, PIMCO

PIMCO's Secular view of Interest Rates: The New Neutral

Where have rates been and where are they going?



As of February 2015
SOURCE: Bloomberg, PIMCO
Refer to the Appendix for additional outlook and risk information

PIMCO's key secular themes and investment implications

Themes

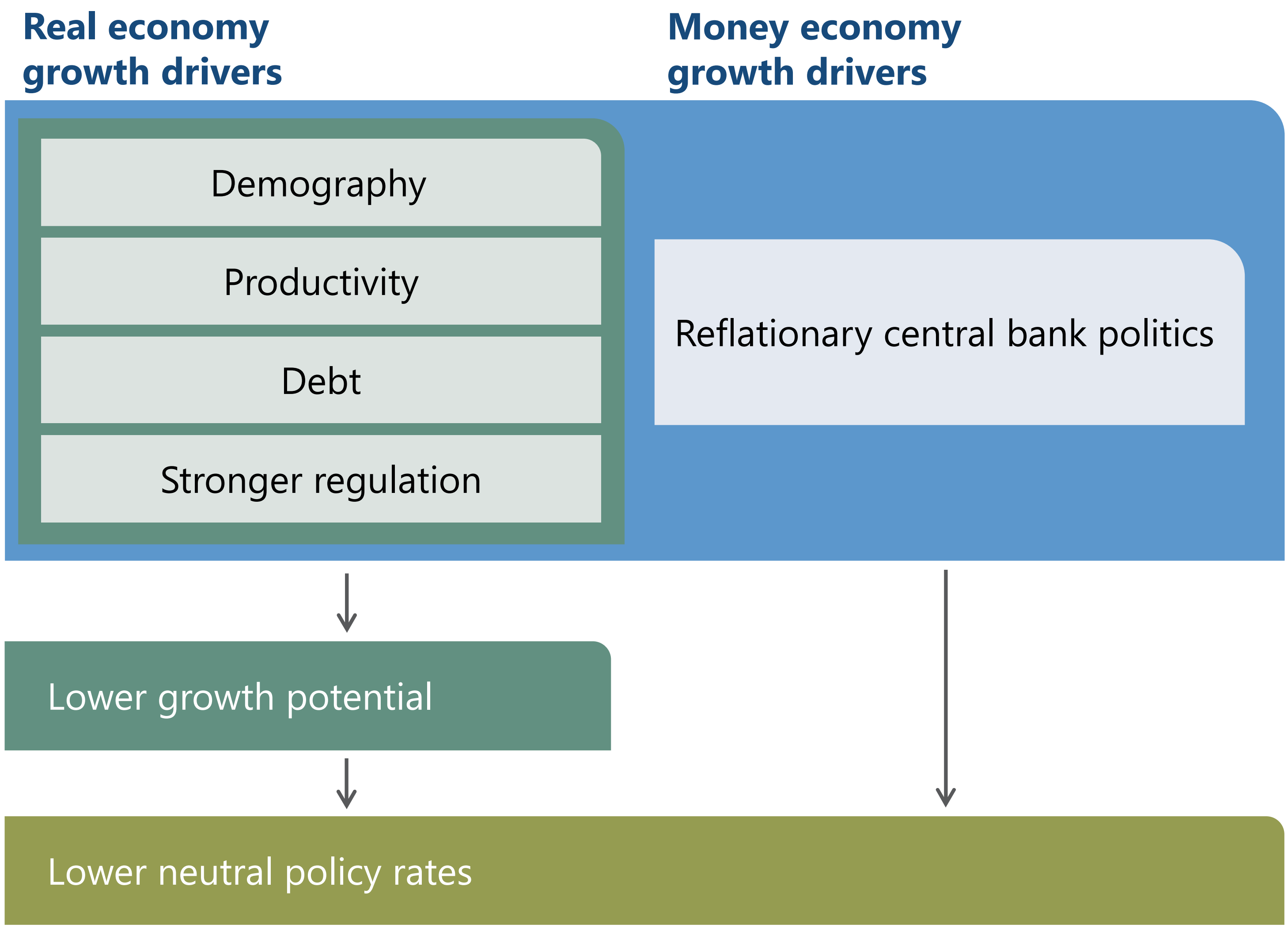
- Global economy will converge to slower yet increasingly stable growth rates with low inflation
- Persistently high global debt and subpar growth will constrain central banks and keep real policy rates near 0%
- U.S. presents wider range of optimistic outcomes than rest of developed world

Investment implications

- Anticipate modest returns, but bear market unlikely:
  - ~3% for bonds
  - ~5% for stocks
- Consider unconstrained, hedge and alternative asset strategies as **carry** increasingly drives performance
- Prioritize bottom-up analysis to identify secular winners (and avoid losers)
- Closely monitor potential Chinese slowdown and impact on global economy
- Expect relatively stable Europe

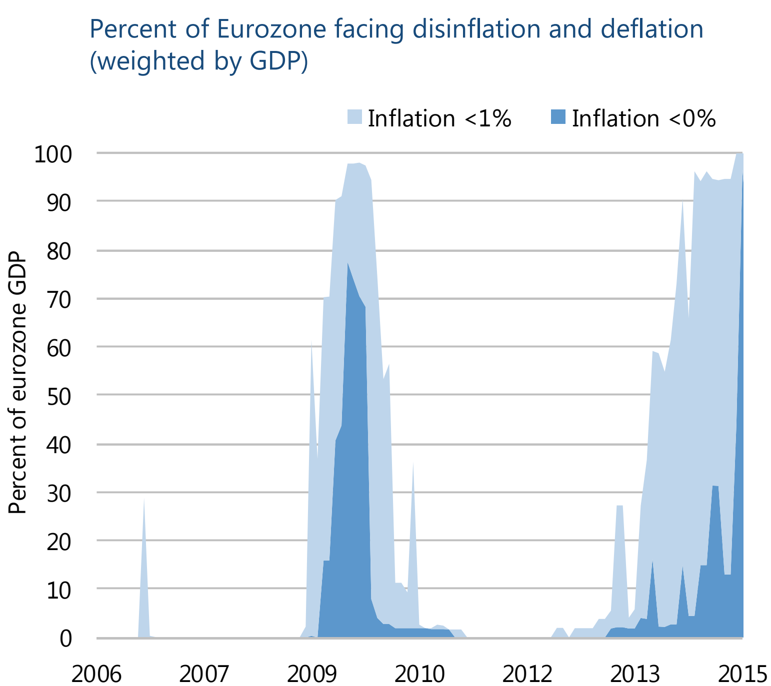
Carry is the rate of interest earned by holding the respective securities
Refer to Appendix for additional forecast, outlook, and risk information.

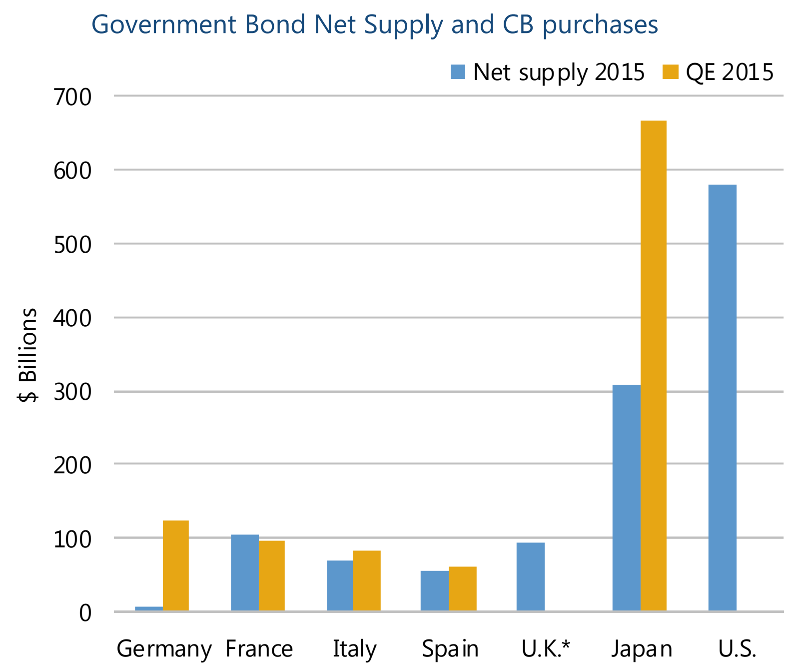
What is the New Neutral?



As of 31 December 2014
SOURCE: PIMCO

Eurozone: Draghi delivers by launching traditional QE and linking it to the ECB's inflation target





The risk of a deflationary spiral spurred ECB action, which exceeded the market's lofty expectations for QE

The size and scope of ECB's QE program provides a tailwind for European sovereign debt and risk assets

The ECB's 60B euro/month of purchases should support financial assets and weaken the euro

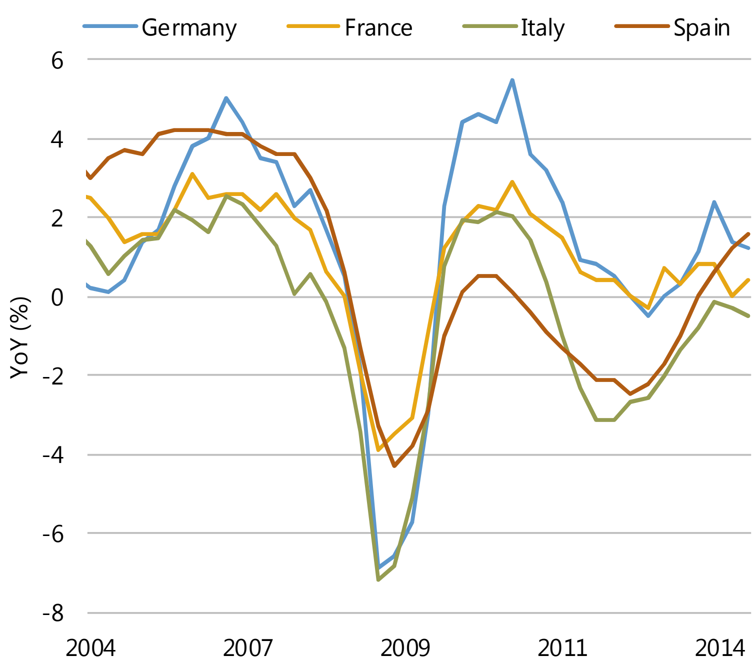
As of 31 March 2015

* UK data uses the UK financial year. Net supply refers to estimated gross issuance less redemptions.

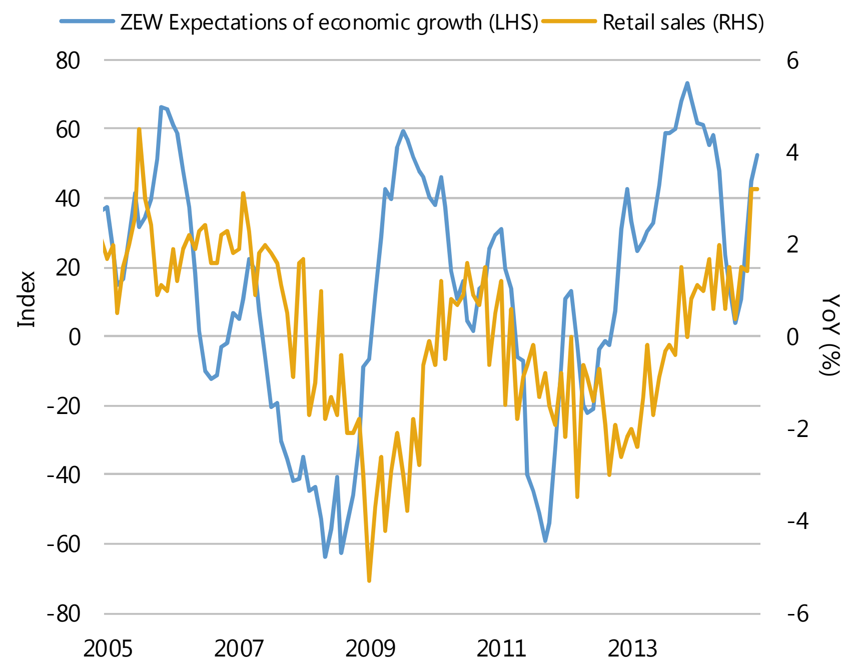
SOURCE: PIMCO and broker estimates for net supply

Eurozone: Pockets of optimism in what had been a subdued landscape

Real GDP growth in the eurozone's Big 4



Eurozone sentiment vs. retail sales



Eurozone growth is shifting from a core vs. periphery dynamic to a more mixed landscape

The cyclical outlook has brightened, aided by the ECB's monetary stimulus

Near-term growth should be above potential, which remains low due to structural challenges

As of 31 March 2015
SOURCE: Bloomberg

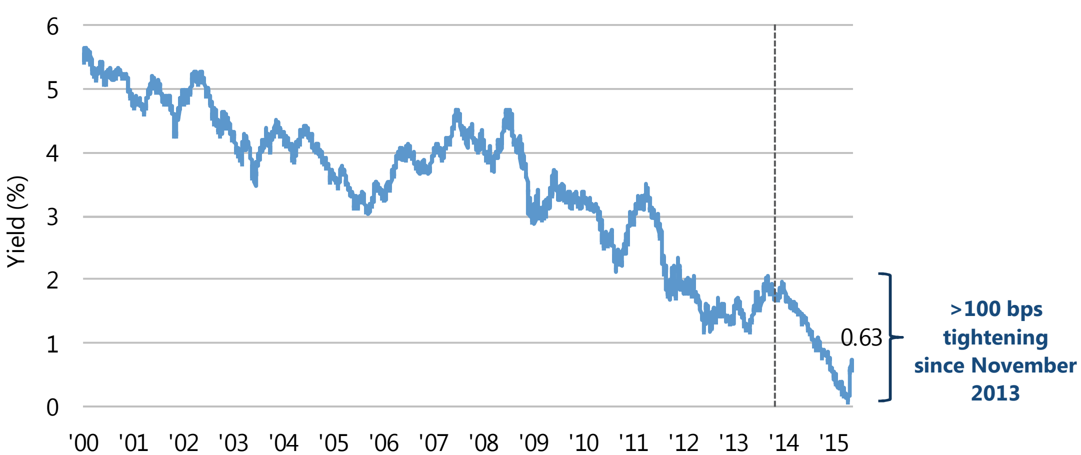
The plight of European Life Insurers in the New Neutral Environment

Key Stakeholders are increasingly concerned

“ I am not sure if all insurers will make it. ”

***German regulator BaFin's Felix Hufeld*, Nov. 2013, on challenges for German life insurers under Solvency II in a low yields environment**

10y German sovereign bond yields [%]



As of 20 May 2015
SOURCE: Bloomberg
For illustrative purposes only

“ (Insurers) pay a huge cost today. ”

***SCOR*, Mar. 2015**

“ With QE widening the gap between the Solvency 2 discount curve and swaps, we worry that the quality of 'tier 1' capital is reducing. ”

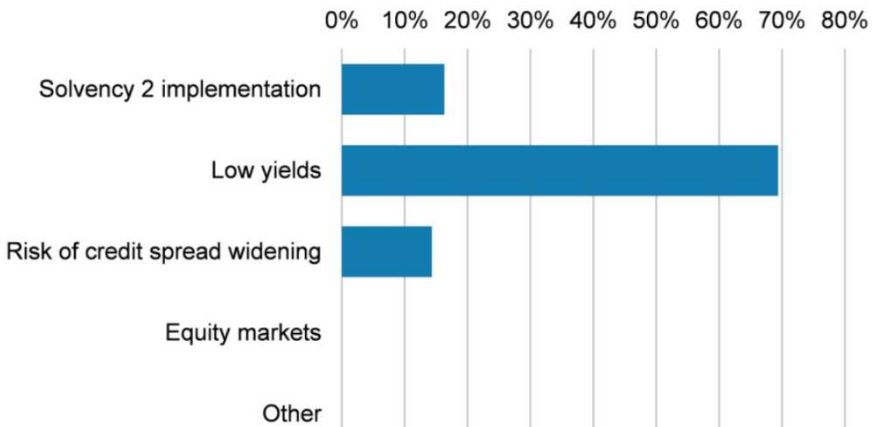
***Morgan Stanley Research*, Feb. 2015**

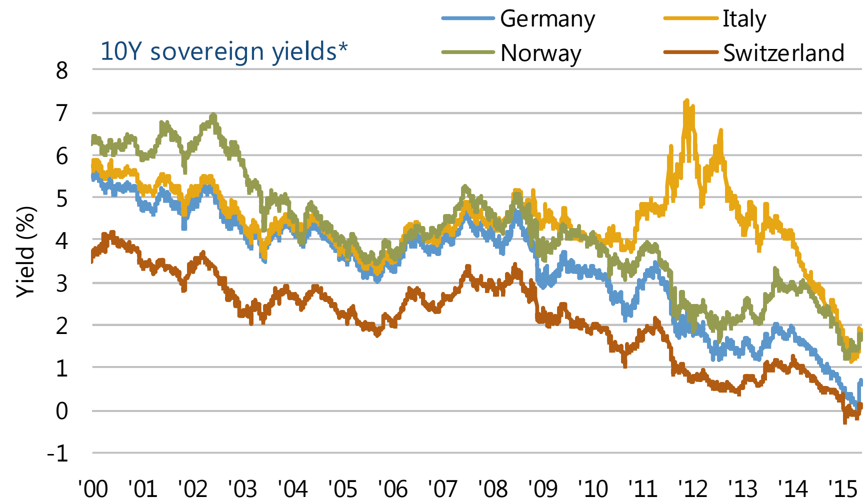
“ This year will be a pivotal and challenging year for Germany's life insurance industry as insurers have to grapple with lower profitability on the back of record-low interest rates and quantitative easing, as well as additional headwinds from regulatory changes. ”

***Moody's*, Jan. 2015**
(neg. outlook for German life)

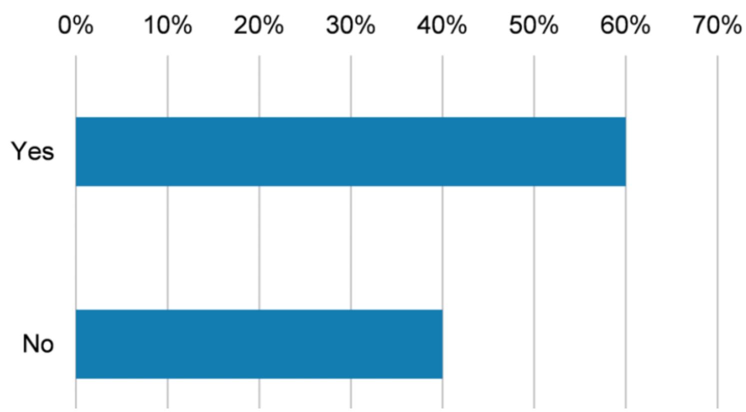
What affects the value of European life insurers

What do investors see as the biggest threat to insurer solvency capital?

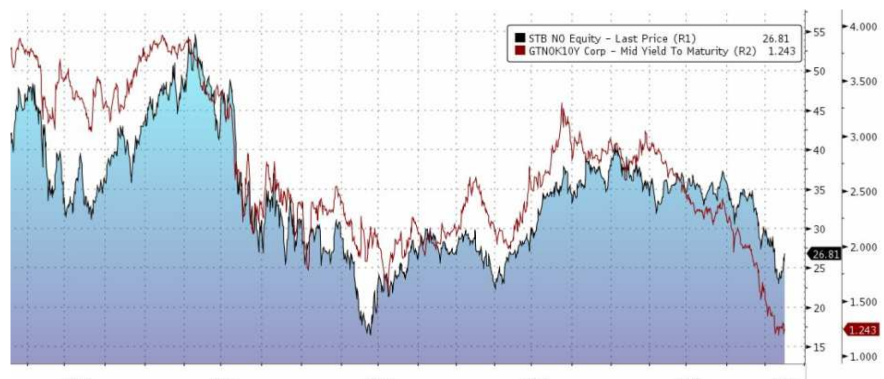




Do investors think we will see more insurers raise equity due to economic capital/Solvency 2?



Storebrand Share Price

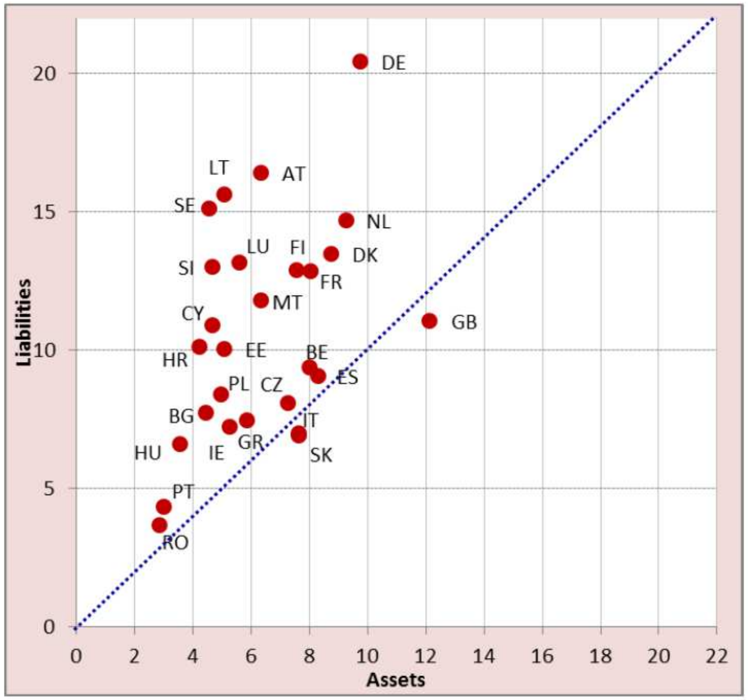


As of March 2015
* As of 20 May 2015
SOURCE: Boomberg, Morgan Stanley European Financials Conference
For illustrative purposes only

European Life Insurance in a Low Yield Environment

Twin economic problems

Asset-liability duration mismatch



Minimum guarantees

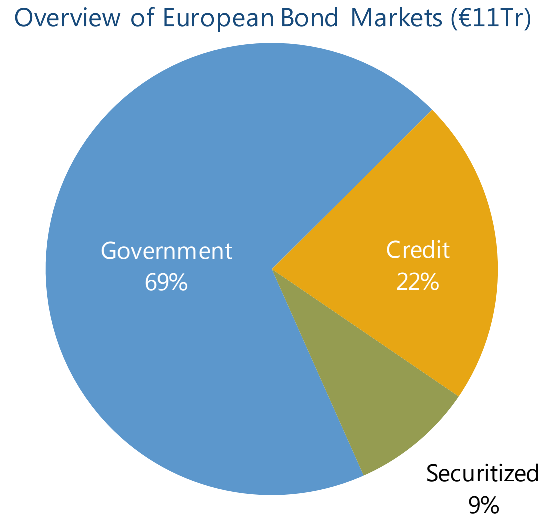
Country	Represent. guarantee [%]	Quantum [EUR bn]	Typical duration of guarantees	10y sov. yield [20 May 2015, %]
Germany	3.1	770	Long-dated / for life	0.6
France	1-1.5	1150	Several years	0.9
Italy	2-2.5	330	Several years	1.8
Netherlands	3.6	190	Long-dated / for life	0.7
Switzerland	2.2	190	Long-dated / for life	0.0
Norway	3.3	90	Long-dated / for life	1.6
Total	2-2.5%	E3Tr	Long dated	Less than 1%

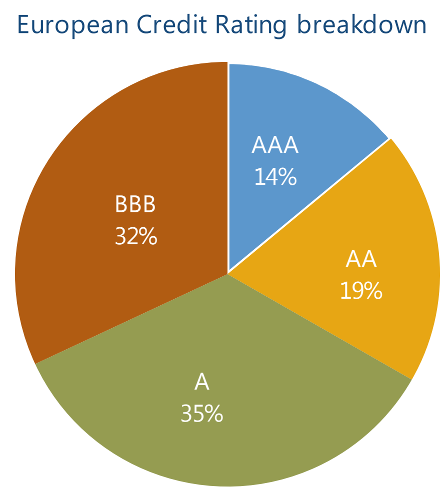
GAP of 1.5%

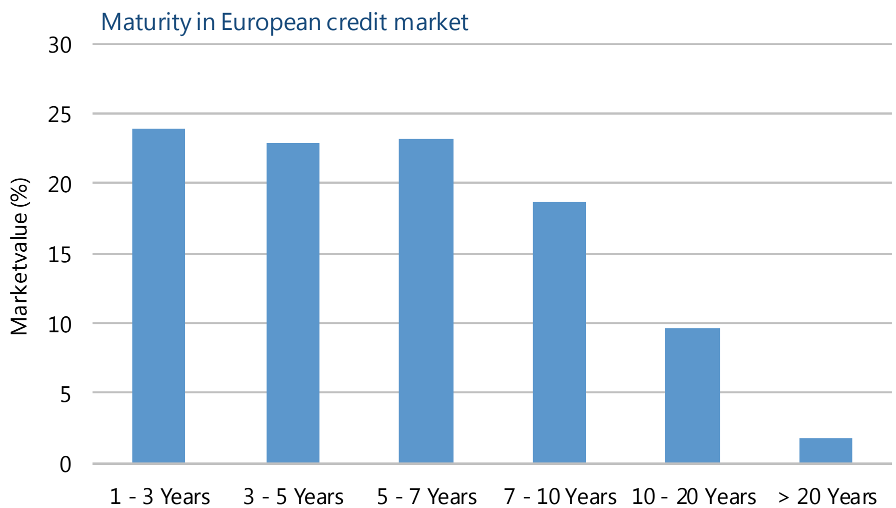
SOURCE: EIOPA 2014 Insurance stress test report , Bloomberg, Moody's, S&P, Insurance Europe, National Regulators

Overview of European Bond Markets

Capital Markets cannot supply enough product to satiate demand







European Credit Spread and Duration breakdown

Quality	Current Spread	Duration
AAA	28	8.1
AA	28	5.5
A	50	5.2
BBB	99	5.0

As of 16 March 2015
SOURCE: European Credit Market represented by Barclays Euro Agg Credit Index
Refer to Appendix for additional credit quality and risk information.

Regulator cannot do more!

Regulatory Treatment of Low Rates Scenario is Extraordinarily Benign

EIOPA 2014 stress test low yields scenario

- Almost a quarter of insurers will not be able to meet the solvency capital requirements (“SCR“) in a prolonged low yields environment
- This stressed test “Japanese“ scenario rates is actually well above current risk free curves

16 year transition periods

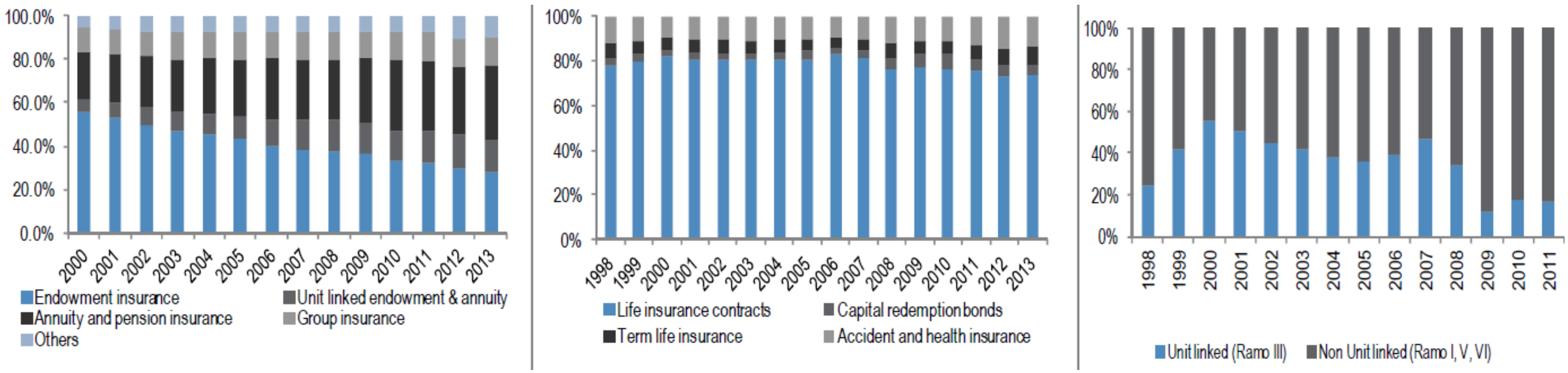
Discount rates

- Ultimate Forward Rates of 4.2% seem indefensible today
- Stress tests are watered down when yield curve is lower (e.g today)
- Volatility adjustment and matching adjustment introduce “off market” features

SOURCE: PIMCO

New Business May Help European Insurers – but Not That Quickly

Slow unit-linked sales in German, France, and Italy [from left to right]



>> Dilution of guarantees will be a matter of many years

SOURCE: J.P: Morgan, GDV, FFSA, ANIA

So what if Low Rates Are Here to Stay?

Potential Insurer and Regulator Reactions

Increasing yield has become THE strategic issue for European Life Insurers

New **product** design:

- Much lower, or no, nominal guarantees (capital guarantee likely essential for value proposition)
- Reset of conditions at end of "savings phase" (using updated capital markets and mortality data in annuities)
- Much stronger focus on unit-linked business, risk products (e.g., disability, term life insurance)
- Change Investment strategies

Dividend cuts and issuance of new equity until weaker players experience serious stress

Forced **M&As**

Portfolios put into **run-off** and establishment of **Protection** schemes (e.g. German Protektor)

Dilution of solvency standards by regulator

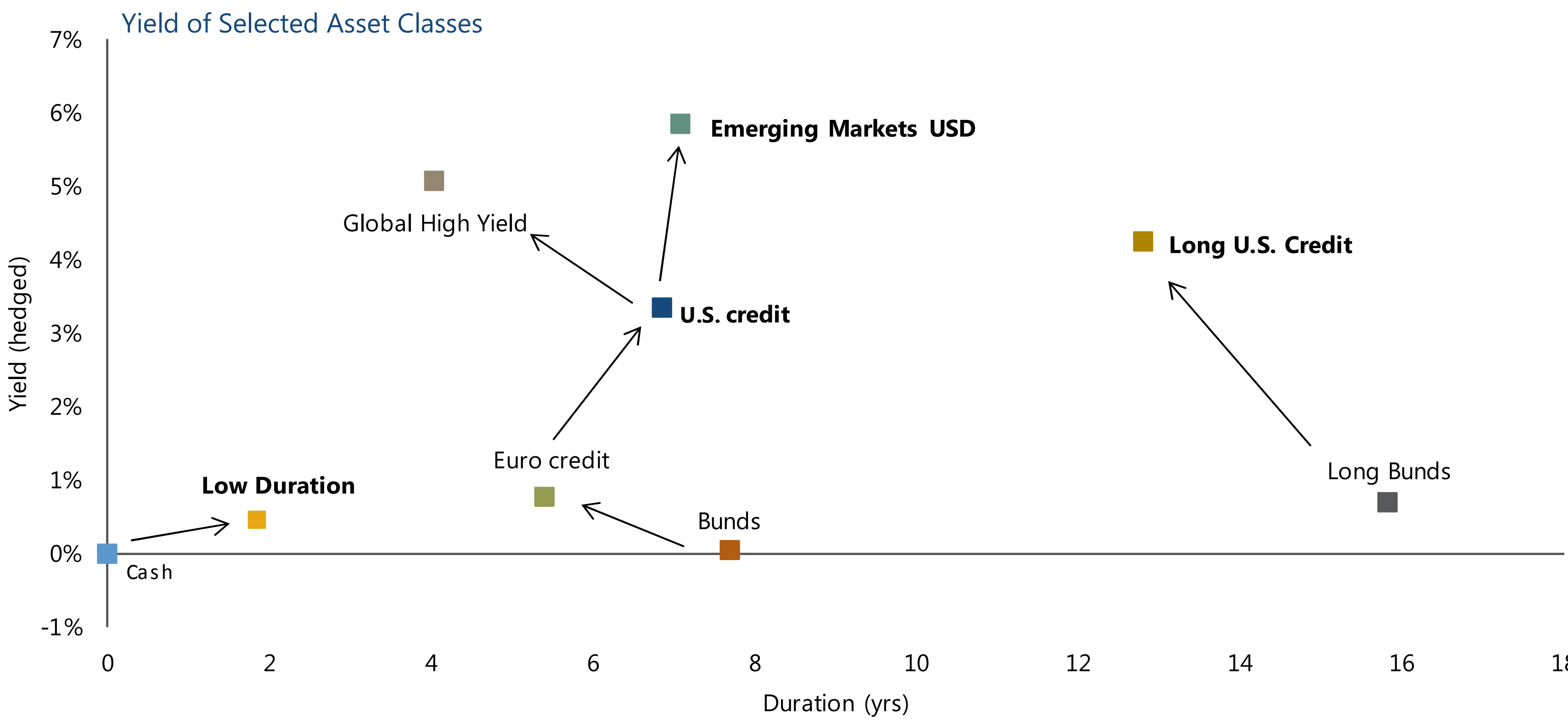
Rewriting of insurance contracts

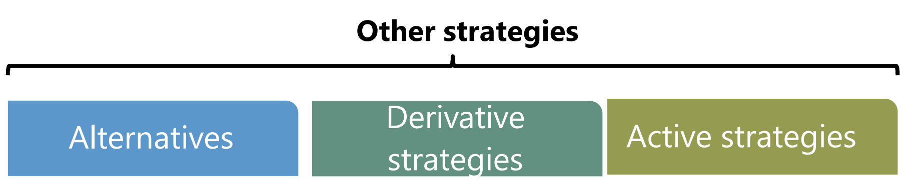
Insolvency

Increasing desperation

SOURCE:PIMCO
Refer to Appendix for additional risk information.

How can Insurers increase Yields?





SOURCE: PIMCO. As of 25 March 2015.
Refer to Appendix for additional GIS funds and risk information.

Key

Low Duration (Global)	GIS Euro Low Duration Fund	**Bunds**	Barclays Germany Treasury
EuroCredit	Barclays EuroAgg Credit	**US Credit**	Barclays U.S. Credit Index
Global High Yield	BofAMLBB-BRatedDvlpdMktsHYHdgdEUR (H4DC)	**EMD USD**	JPM EMBI Global Hedged Euros
Long Bunds	BofA ML German Federal Governments 10+	**Long US Credit**	Barclays US Long Credit Index

Appendix

Past performance is not a guarantee or a reliable indicator of future results

DIVERSIFICATION
Diversification does not insure against loss.

CREDIT QUALITY
The credit quality of a particular security or group of securities does not ensure the stability or safety of the overall portfolio.

INVESTMENT STRATEGIES
There is no guarantee that these investment strategies will work under all market conditions and each investor should evaluate their ability to invest for a long-term especially during periods of downturn in the market. No representation is being made that any account, product, or strategy will or is likely to achieve profits, losses, or results similar to those shown.

OUTLOOK AND STRATEGY
Statements concerning financial market trends are based on current market conditions, which will fluctuate. There is no guarantee that these investment strategies will work under all market conditions, and each investor should evaluate their ability to invest for the long-term, especially during periods of downturn in the market. Outlook and strategies are subject to change without notice.

RISK
An investment in high-yield securities generally involves greater risk to principal than an investment in higher-rated bonds. The credit quality of a particular security or group of securities does not insure the stability or safety of the overall portfolio. Portfolios may use derivative instruments for hedging purposes or as part of the investment strategy. Use of these instruments may involve certain costs and risks such as liquidity risk, interest rate risk, market risk, credit risk, management risk and the risk that a portfolio could not close out a position when it would be most advantageous to do so. Portfolios investing in derivatives could lose more than the principal amount invested. Each sector of the bond market entails risk. Municipals may realize gains and may incur a tax liability from time to time. The guarantee on Treasuries, TIPS and Government Bonds is to the timely repayment of principal and interest, shares of a portfolio that invest in them are not guaranteed. Mortgage and asset-backed securities are subject to prepayment risk and may be sensitive to changes in prevailing interest rates, when they rise the value generally declines. With corporate bonds there is no assurance that issuers will meet their obligations. An investment in high-yield securities generally involves greater risk to principal than an investment in higher-rated bonds. Investing in non-Euro securities may entail risk as a result of non-Euro economic and political developments, which may be enhanced when investing in emerging markets. Diversification does not insure against losses.

MODEL
The above unconstrained model is a representation of a model portfolio and no guarantee is being made that the structure of other similar portfolios will remain the same or that similar results will be achieved.

OPTION ADJUSTED SPREAD (OAS)
The Option Adjusted Spread (OAS) measures the spread over a variety of possible interest rate paths. A security's OAS is the average return an investor will earn over Treasury returns, taking all possible future interest rate scenarios into account.

It is not possible to invest directly in an unmanaged index.

Appendix