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# Extracting value from alternative assets through innovative investment vehicles

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***“We did not come here to fear the future. We came here to shape it.”***

- Barack Obama

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# Contents



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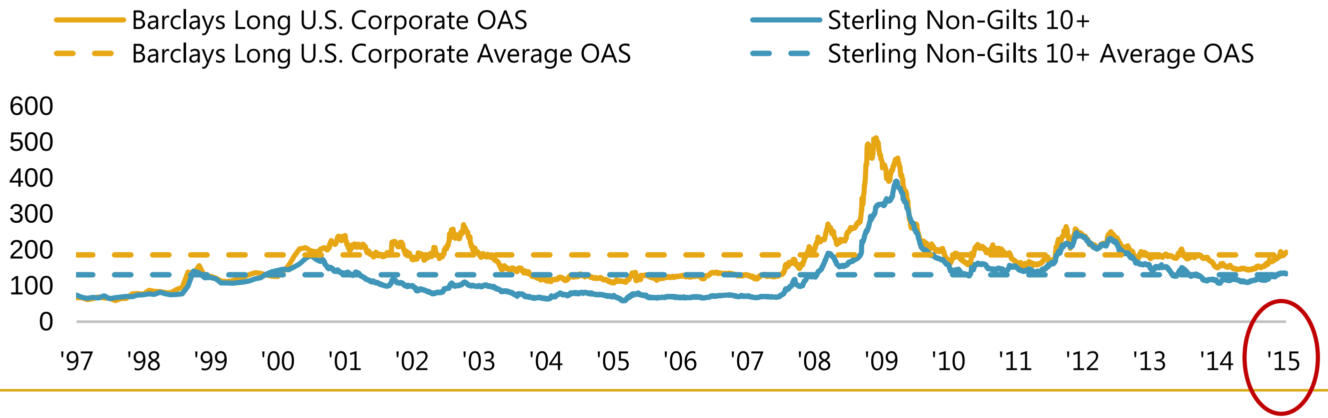
# Are alternative assets a solution to a sustained low yield environment?

# The search for yield continues amidst a challenging economic backdrop

- The stock market has delivered strong returns despite recent volatility


- Spreads remain low but not far off long term averages

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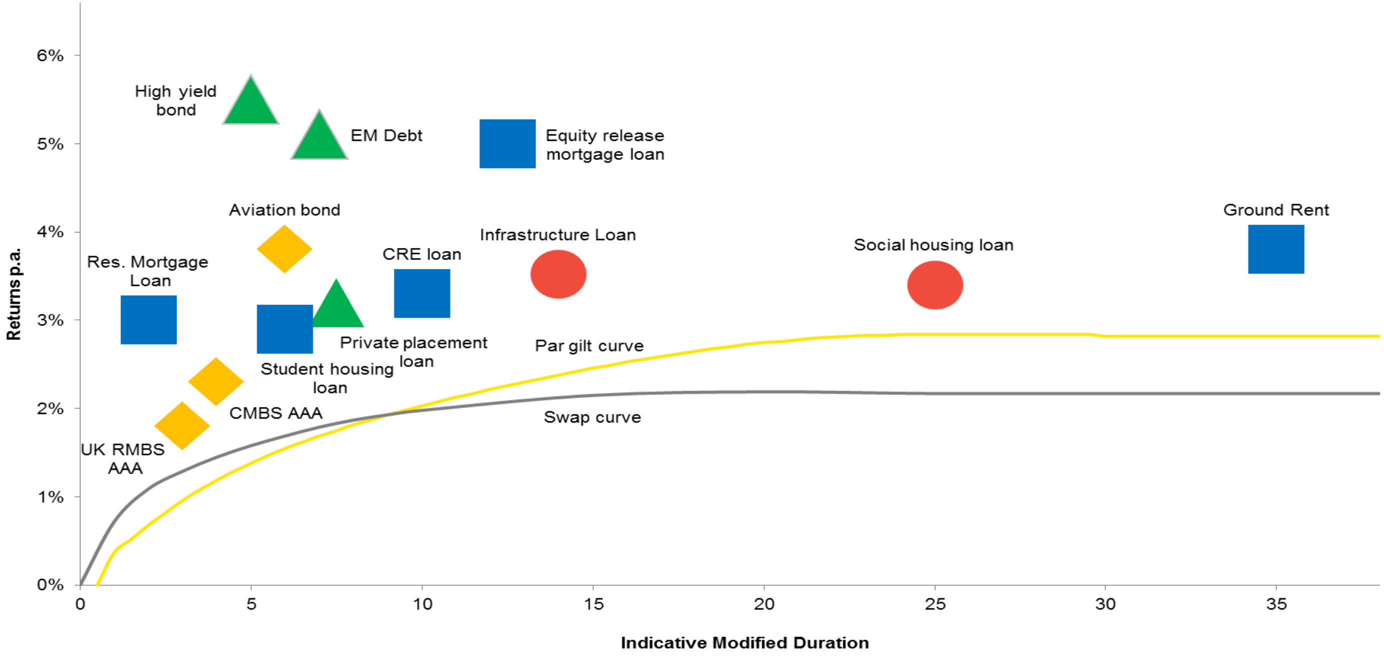
# Alternative assets could provide the risk-adjusted return to satisfy insurance investor requirements




**Source:** EY with template from IFoA non-traditional working party

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# Potential investment obstacles and challenges

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# Practical, technical and regulatory obstacles need to be navigated

**Practical**
- Availability of investment opportunities can be restrictive
- Management of assets can be onerous

**Technical**
- Mark-to-model pricing / valuation likely to be required
- Understanding of new risks required including investment due diligence

→
- Outsource
- Up-skill internally
- External advisors

**Regulatory**
- Capital requirements may be onerous (may need Internal Model)
- Standard covenants / clauses can be unfavourable (e.g. for Matching Adjustment ("MA") compliance)

→
- ***Re-structure***

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# Tools and techniques to facilitate efficient insurance investment in alternative assets

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# The tools to facilitate alternative asset investment can be complex, but rewarding

| Obstacle | Potential tools | Reward |
|---|---|---|
| Lumpy cash-flows | ▪Liquidity swap<br>▪SPV / securitisation | Improved liability matching |
| High capital charge | ▪Credit wrap / enhancement | Lower capital charge |
| Volatile cash-flows | ▪Derivatives (e.g. TRS)<br>▪SPV / securitisation | Better matching<br>Lower capital |
| Covenants / clauses | ▪SPV / securitisation<br>▪Exotic derivatives | MA compliance |

An Internal Model is may be required to maximise the benefit of alternative asset investment

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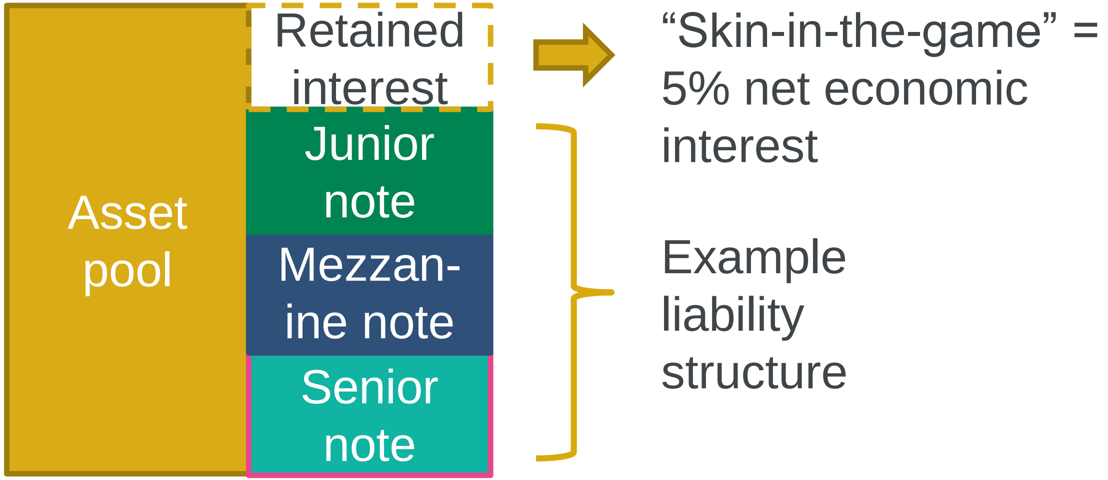
# Case study: sculpting your investment through Special Purpose Vehicles ("SPVs")

# An SPV can be used to sculpt investments that meet an insurers specific risk / return objective

- The SPV owns the alternative asset pool
- Expected cash-flows are tranched
- Instruments are issued to investors with desirable structural features

**Example SPV structure**

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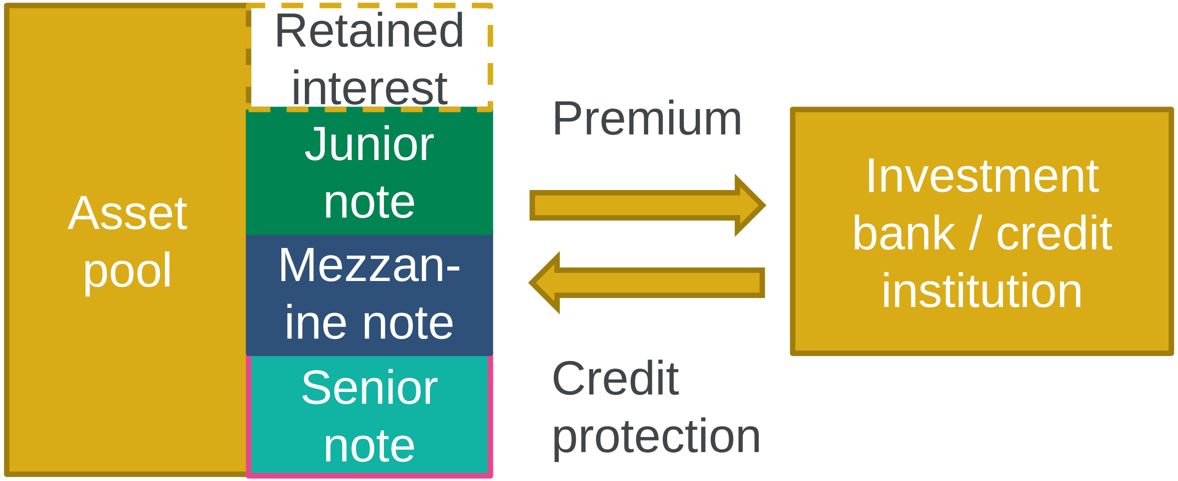
# Capital requirements can be reduced through increasing credit quality of the notes

- A third party can provide credit enhancement
- Additional security is likely to reduce capital requirements

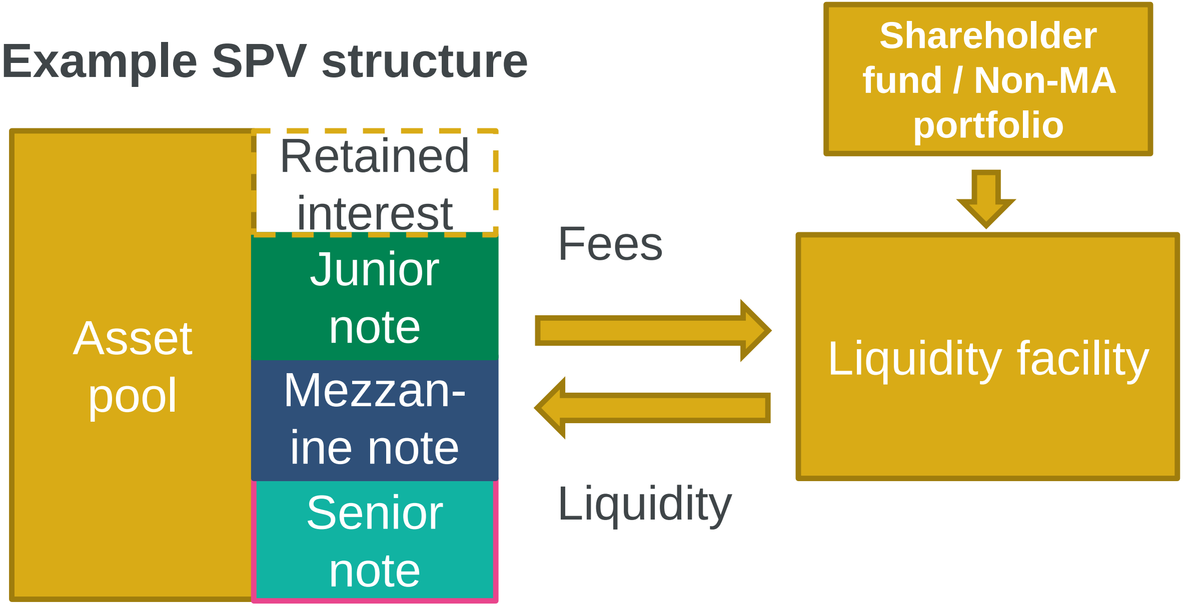
**Example SPV structure**



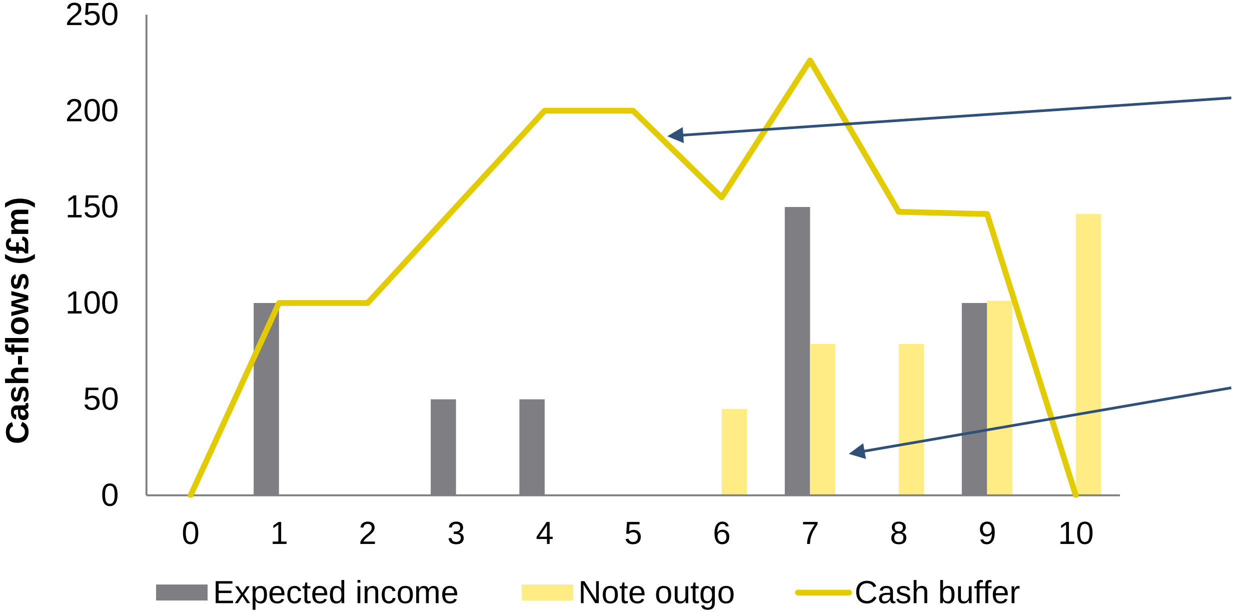
# Other techniques can be used to enhance credit quality and reduce default risk

- A liquidity facility can reduce probability of default due to cash-flow volatility
- Facility is available to meet senior note obligations
- Liquidity facility is provided by another entity in the insurer

**Example SPV structure**



# Other techniques can be used to enhance credit quality and reduce default risk

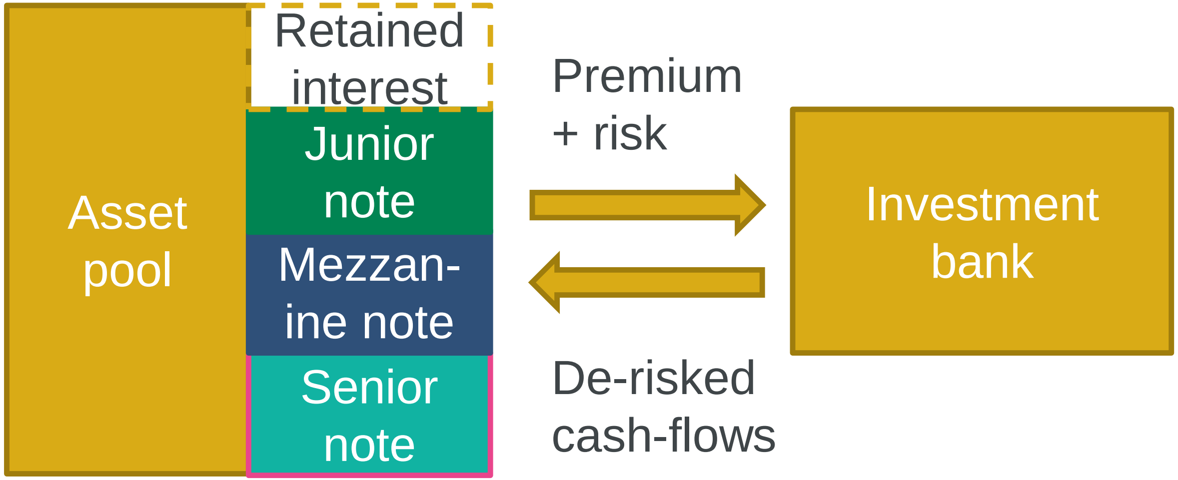



- Cash-buffer can be built up inside the vehicle
- Triggers for payment to junior note
- Optimise the note payment schedules for risk v return

# Unwanted risks can be managed within the structure or passed to a third party

**Example SPV structure**

- Risks such as interest rate, currency etc. can be managed easily
- Exotic instruments could be transacted to remove other undesirable risk (e.g. prepayment)

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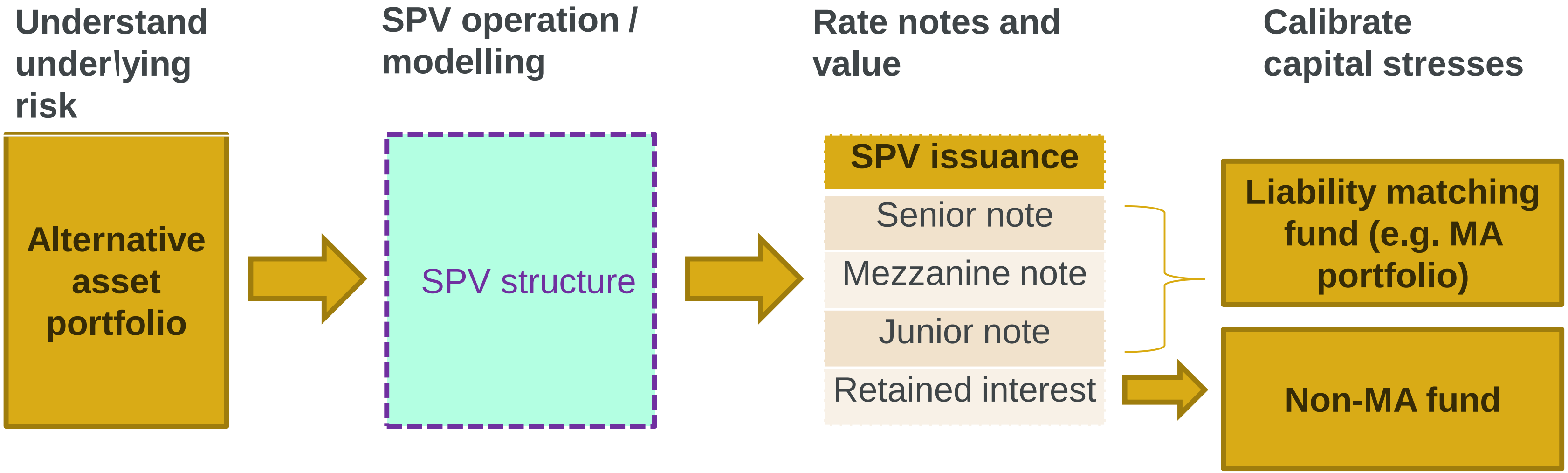
# Some practical and technical obstacles still exist




- Prudent risk management is required including sensible limits
- The PRA recently set out a four level framework for investment supervision: (i) why; (ii) how; (iii) due diligence; (iv) internal evaluation and possible actions

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# Concluding remarks

# Structuring alternative assets was an emerging trend in 2015 and we expect it to continue

- Insurers are looking for an attractive risk-adjusted return to combat low yields and alternative assets provide a potential solution
- However, firms may be concerned with the obstacles to investment
- Structuring solutions are being investigated and transacted in the market to facilitate investment alternative assets for insurers
- We anticipate this to continue as:
    - Insurers attempt to apply structuring solutions to a wider range of problems (e.g. secondary annuities, physical assets?)
    - Insurers can reapply solutions and improve efficiency due to "lessons learned"
- Structures are likely to get more sophisticated as insurers up-skill internally

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# Questions

# Comments

Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

The views expressed in this presentation are those of the presenter.

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Gareth is EY's UK Lead for Investment Advisory services. In this role Gareth provides institutional investors and asset management clients with support, predominantly in the insurance and pensions sector. He is a qualified actuary with 13 years' experience ranging across investment strategy, treasury, private equity, ALM and transactions. Gareth joined EY in 2014 from L&G where he spent 3 years working in investment strategy and treasury. Prior to this, Gareth spent 2 years working for a real estate investment firm, negotiating property debt facility agreements and sale & purchase agreements, running transaction processes, assessing target acquisitions and working on investor relations

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Sam is a Manager in EY's Investment Advisory team. He has been with EY for five years where he has developed experience restructuring alternative and illiquid investments for insurers, developing investment funds to meet insurer's investment objectives and supporting insurers with deployment into illiquid assets. Sam has also acquired experience of calibrating credit and market risk capital models and developing mark-to-model valuation methodologies for illiquid and alternative investments. Sam is also a qualified actuary.

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