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Private Credit

Iain Forrester

Chair, “Private Credit for Insurers” working party

27 September 2017



Agenda

- Insurance Investment Environment
- “Private Credit for Insurers” Working Party
- Considerations for Bulk Purchase Annuity Market



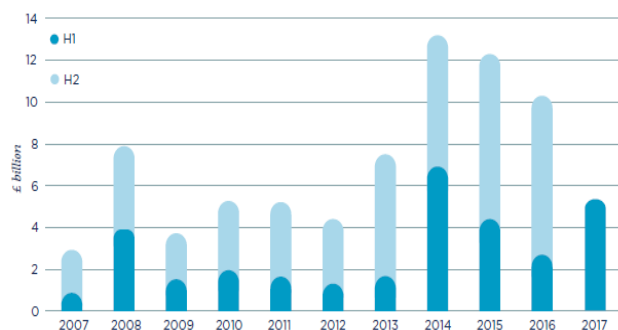
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Bulk Annuity Market

Buy-in and buy-out volumes over time



Source: LCP Pensions de-risking update – August 2017



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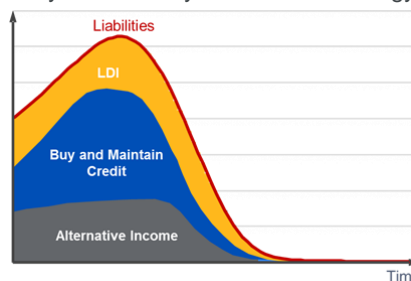
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Annuity Investment Strategies

- 1 Majority of portfolio invested in government bonds and corporate bonds.
- 2 Significant investment in mortgages – these may be either ERM, which are secured on residential property, or commercial real estate loans.
- 3 Strategies which focus on private forms of lending – this can often take the form of a bilateral deal between the insurer and the borrower, and the loan may be secured on some form of asset.

Stylised Annuity Investment Strategy



Source: Hymans Robertson, Risk transfer report, August 2017

Source: Aviva Investors, "Think like an insurer, invest like a pension scheme", February 2016



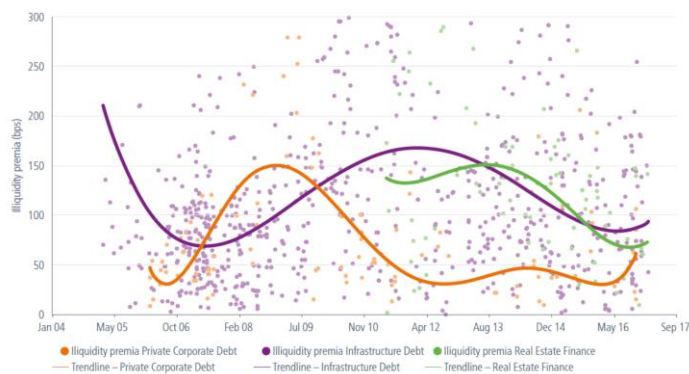
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Why Private Credit?

“Private Credit” - fixed income asset with no active secondary market.



Source: Aviva Investors, “The case for alternative income: Private assets and the illiquidity premium.”

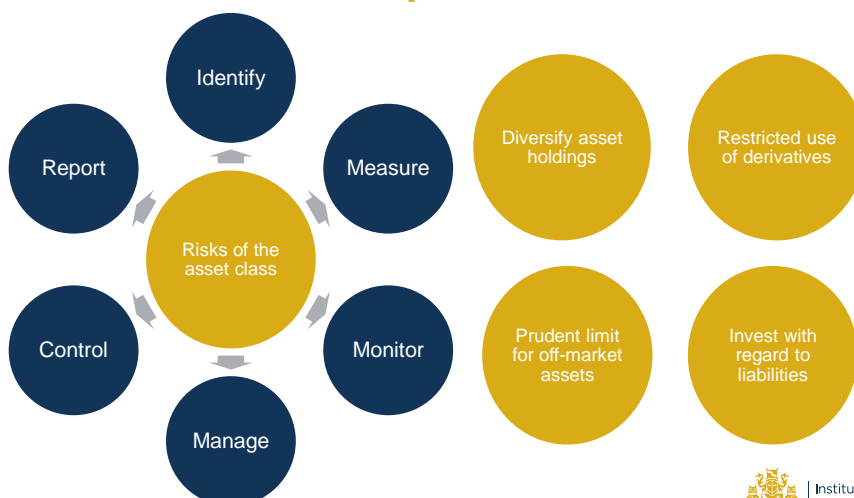


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Prudent Person Principle

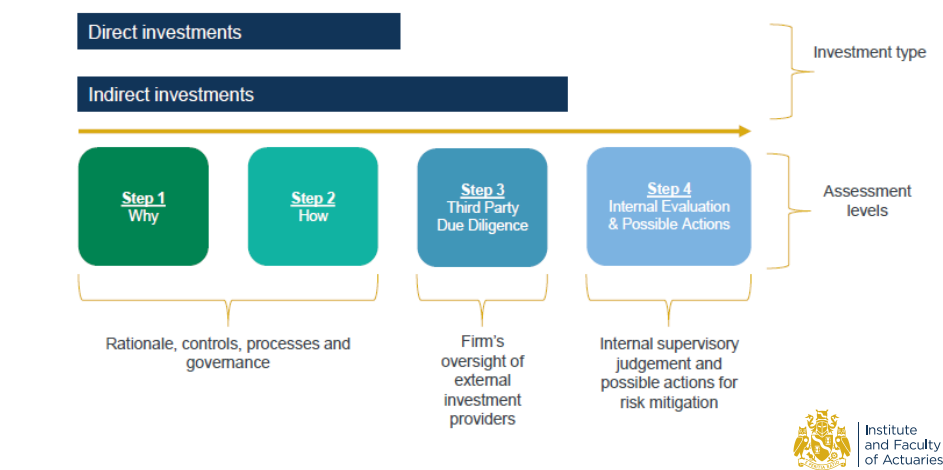


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The PRA's Investments Framework



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Regulatory Perspective

Sam Woods, Chief Executive Officer, Prudential Regulation Authority:

*"... illiquid bespoke loans require very specific skills in terms of **structuring, valuation and ongoing risk management**. In particular, experience has taught us that the risk firms face from making such loans is related to how skilfully firms can **manage any impairment process**. These are not traditional areas of expertise for most UK insurers and, in my view, firms must clear a high bar in order to demonstrate that they have **adequate systems and controls** in place to manage these types of risks and exposures."*

Source: Speech, London Business School, 20 March 2017

Working Party Members

The Working Party comprises individuals in the following roles:

- Insurance Investment - 1st Line
- Insurance Investment - 2nd Line
- Asset Management
- Insurance Investment Consultant

Working Party Members		
Mike Ashcroft	James Hayes	James Lumb
Daniel Blamont	Roman Hederer	Gareth Mee (Deputy Chair)
Iain Forrester (Chair)	Wojciech Herchel	Rui Wang
Paul Harbord	David Leach	

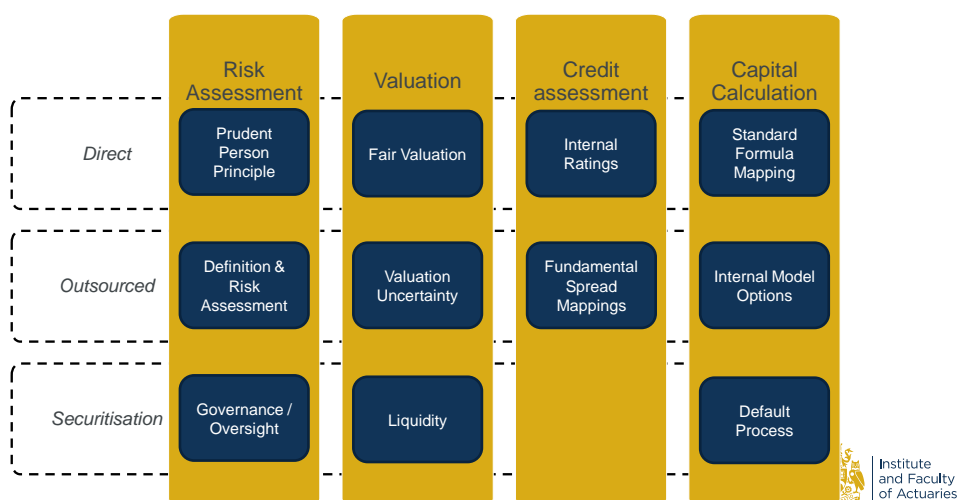


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Private Credit – Key Considerations



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Risk Assessment

Definition of
Investment
Universe

Specialist
Expertise

Outsourcing

Governance /
Oversight



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Valuation

Quantifying
Risk Premia

Valuation
Uncertainty

Restructured
Assets



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Credit assessment

Internal Rating Framework should cover:

Methodology

Calibration and
back testing

Governance around
rating process

Process for regular
review

Rating *broadly
consistent with
rating produced
by ECAI...*

Rating based on
Probability of
Default or
Expected Loss...

How much
internal expertise
is required...



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Capital Calculation

Consistency
with Fair
Value

Data

Complexity

Credit Ratings
under Stress



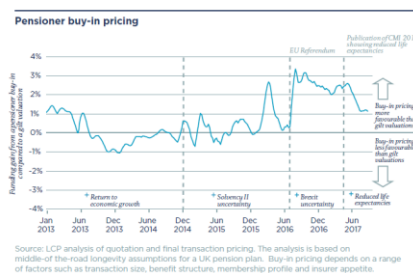
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Considerations for the Bulk Annuity Market

- Insurance annuity back-book transactions
- Investment opportunities – avoiding insurance demand
- Cashflow-driven investment
- Bulk annuity pricing



Source: LCP Pensions de-risking update – August 2017



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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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