Institute
and Faculty
of Actuaries

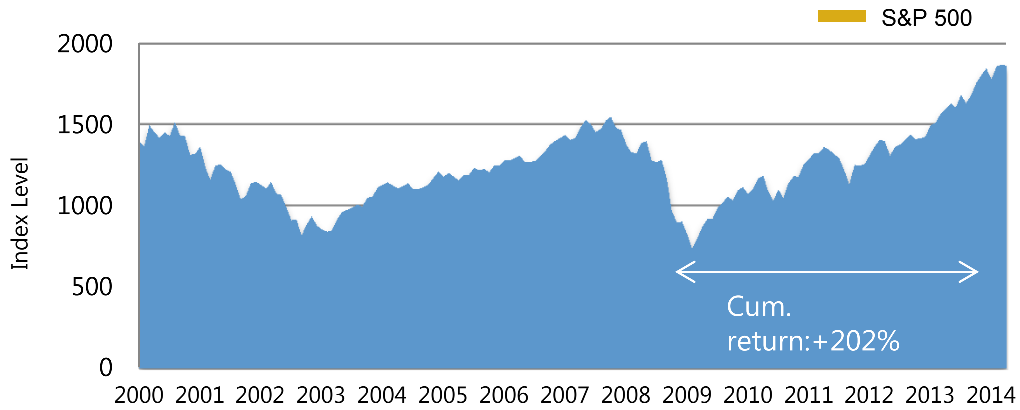
Investment Opportunities for General Insurance Firms

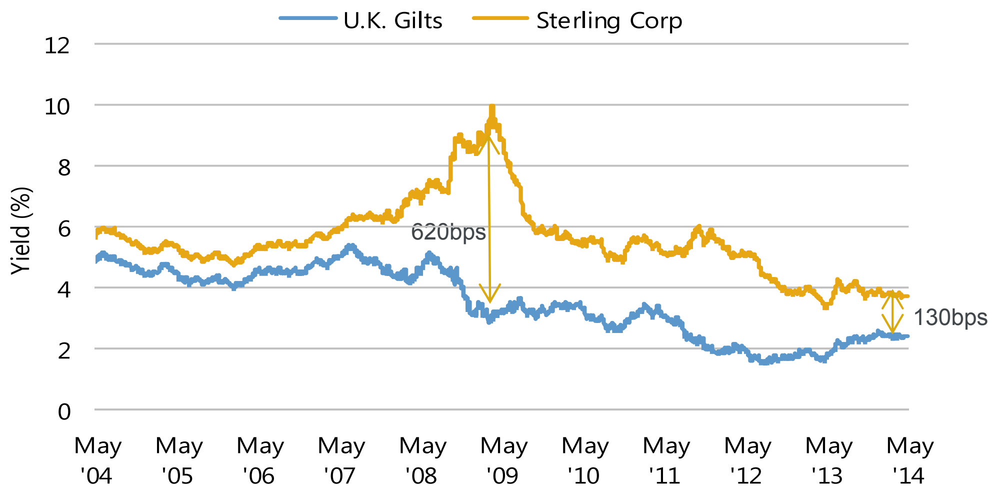
Gareth Mee & Eugene Dimitriou (on behalf of the non-traditional assets working party)

24 September 2014

Economic Backdrop - are the Markets overheating?

- The stock market has delivered strong returns …



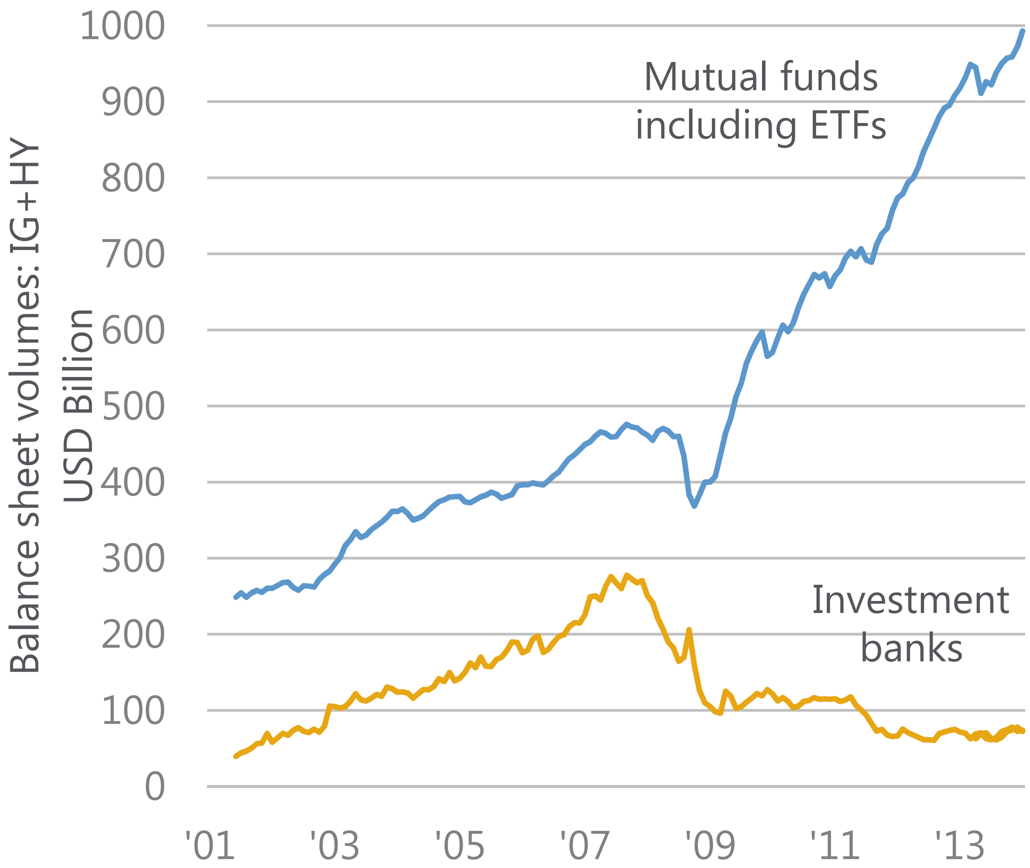


- Meanwhile, spreads in fixed income markets grind in tighter and tighter

As of May 2014 SOURCE: Bloomberg, BofA Merrill Lynch (BofA Merrill Lynch Sterling Corporate Index and BofA Merrill Lynch UK Gilt Index)

Institute and Faculty of Actuaries

The Changing Complexion of Fixed Income Investing



- **Challenges for Insurers as Investors:**
  - Need to invest as a function of liabilities
  - Wide number of Constraints (regulatory, rating agency, tax, etc)
  - Perceived inability to act quickly
- **Advantages of Insurers as Investors**
  - Size of balance sheets
  - Ability to divorce funding from risk taking activities
  - Low liquidity requirements/ability to be patient

Does this create investment opportunities for insurers?

As of 28 February 2014. SOURCE: Haver, PIMCO.

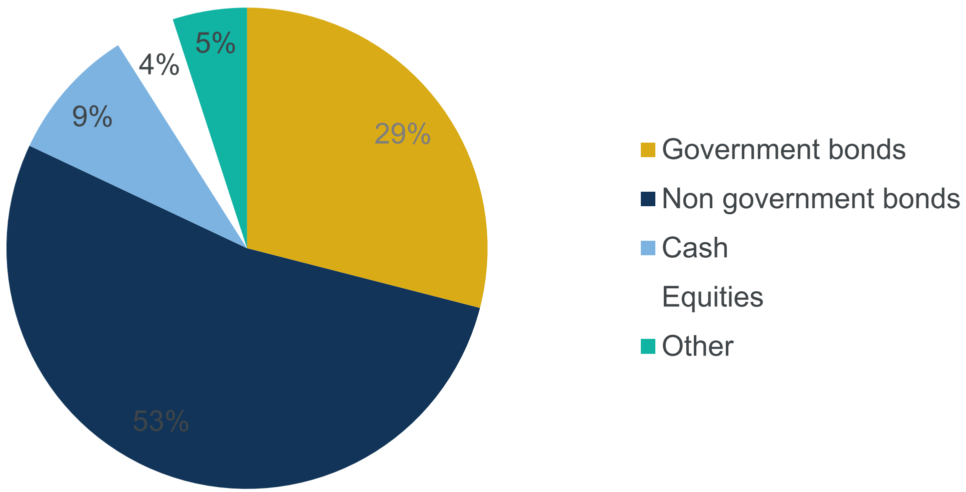
Institute and Faculty of Actuaries

Current Investment Strategies

- The following table shows an average return on investment for the last 5 years for 3 major general insurers:

2008	2009	2010	2011	2012
-1.4%	5.9%	2.8%	3.2%	2.9%

- Investment strategies are seen to be conservative, erring on the cautious side of the risk to return relationship given the ongoing uncertainty in financial markets.
- Asset allocations tend to be highly focused on fixed income investments and cash as can be seen in the following breakdown of a major insurer:

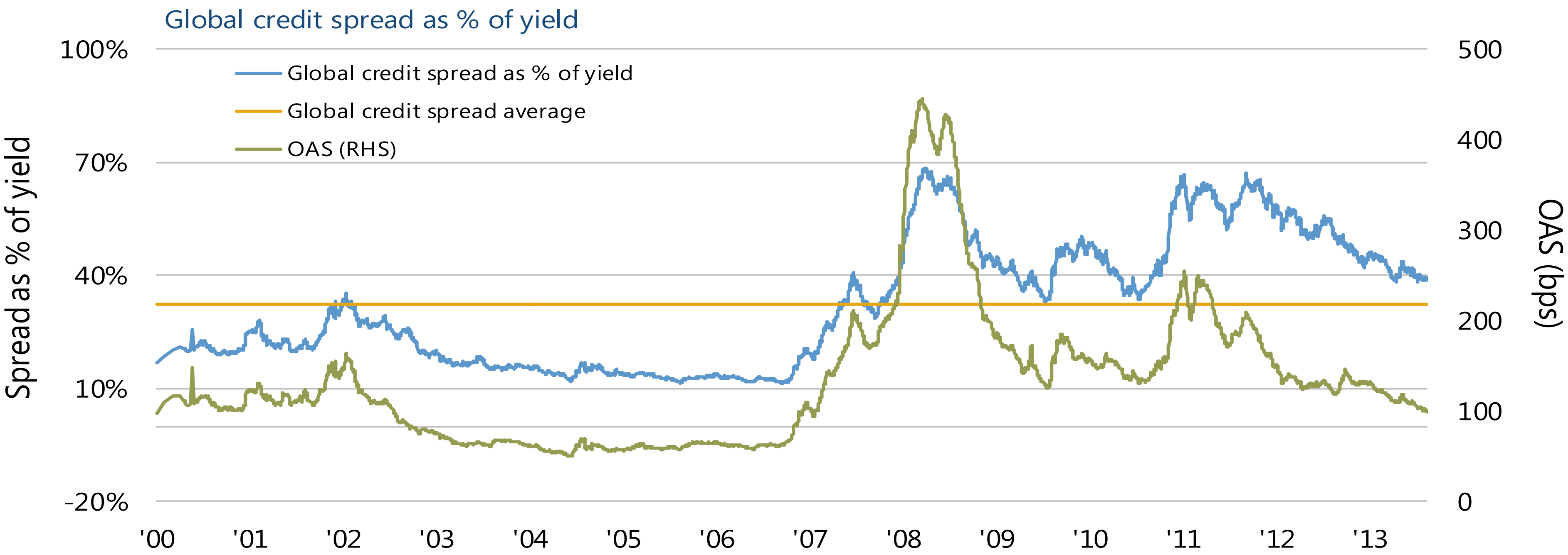


2014 Trends for European Insurers' Investments

- The trend to diversify away from euro government bonds and to go global remains intact
  - More global credit, including U.S. credit
  - More emerging market debt
  - Peripheral credits such as Spain and Italy are increasingly acceptable
  - Renewed interest in financials as a source of reasonable yield and liquidity
- Secular interest in income generating high quality substitutes for bonds:
  - Asset classes with attractive yields / low default risk
  - Secured lending, e.g. commercial real estate, aircraft leasing
  - Infrastructure debt
- Some appetite for private equity and hedge funds as alternatives to equities
- Ongoing evidence of hedging the tail risk in rates (both rates up and down), equities and credit
- Some loosening of portfolio management constraints (e.g. increased manager discretion)
- Increasing buy and hold orientation, prompted in part by regulation e.g. Solvency II

The dominant current trend is the search for yield

Credit selection becomes more important than ever



Credit spread today represents 40% of overall yield compared to 13% in 2007

As of 12 May 2014
SOURCE: PIMCO

Institute and Faculty of Actuaries

Institute and Faculty of Actuaries

Institute Working Party

Overview

- Working party formed in October 2013 to:
  - educate insurers on the types of alternative assets and their characteristics and risks
  - work with regulators / other professional bodies on behalf of the profession
- Research so far focused on
  - Development of research material on five subgroups of alternative assets, with a focus on fixed income
  - Development of research material on potential constraints and issues for insurers investing in alternative assets

Institute and Faculty of Actuaries

Types of Investment Opportunities

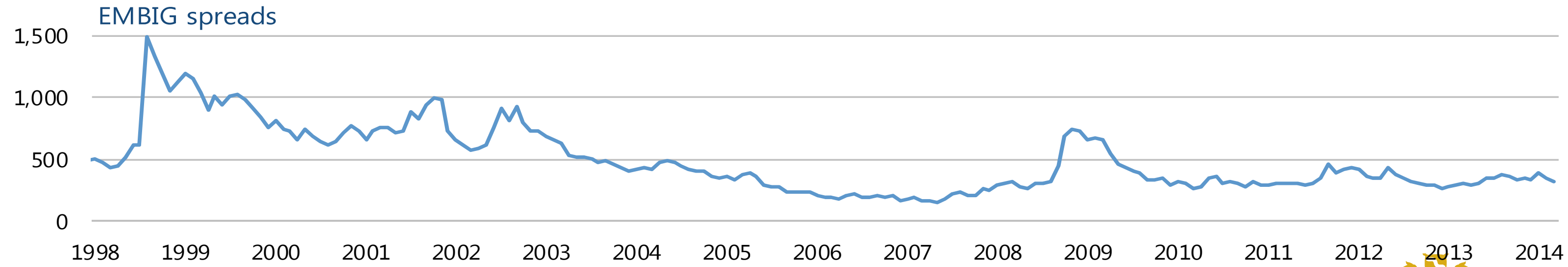
Type of inves-tment	Examples	Pricing Trans-parency	CF certainty	Ability to source	Ongoing mgment
Infra-structure	Social infrastructure, economic infrastructure, energy (including renewables)	Low	High	Medium	Complex
Real estate backed	Residential & commercial lending, social housing, student accommodation, equity release, ground rent	Low	Medium	Medium – difficult	Complex
Other asset backed	Asset backed securities, collateralised loan obligations, aircraft financing, shipping financing	Medium - High	Medium	Easy	Simple
Other un-secured	Private placements, SME lending, high yield, overseas (including emerging market) debt	High	High	Easy	Simple
Other	Private equity, hedge funds, insurance linked securities	Low	Low	Easy - Medium	Medium

Institute and Faculty of Actuaries

The Emerging Markets have Emerged

	1990's: "Old" World	2000's and post-Financial Crisis: "New Normal"	present day: "T junction"
Global Conditions	▪ High growth across most of the world	▪ Multi-speed World with EM leading the way	▪ Transitioning growth models; EM still higher growth than DM
EM Conditions	▪ Frequent balance of payment crises ▪ High levels of indebtedness ▪ Balance sheet FX mismatches ▪ Unstable policy making	▪ Stronger balance sheets (lower debt, current account surpluses) ▪ Developing local debt markets ▪ Credible central banks ▪ Abundant capital ▪ Strong growth ▪ Rising credit ratings	▪ Some countries have strong fundamentals and are resilient to exogenous shocks ▪ Other countries have current account imbalances, exposure to volatile portfolio flows, and policy responses are haphazard and indecisive
Investment Characteristics	▪ Developed economies = interest rate risk ▪ Emerging economies = credit risk	▪ Credit risk introduced to developed economies ▪ Interest rate risk introduced to emerging economies	▪ DM unconventional monetary easing ▪ Increased country differentiation within EM

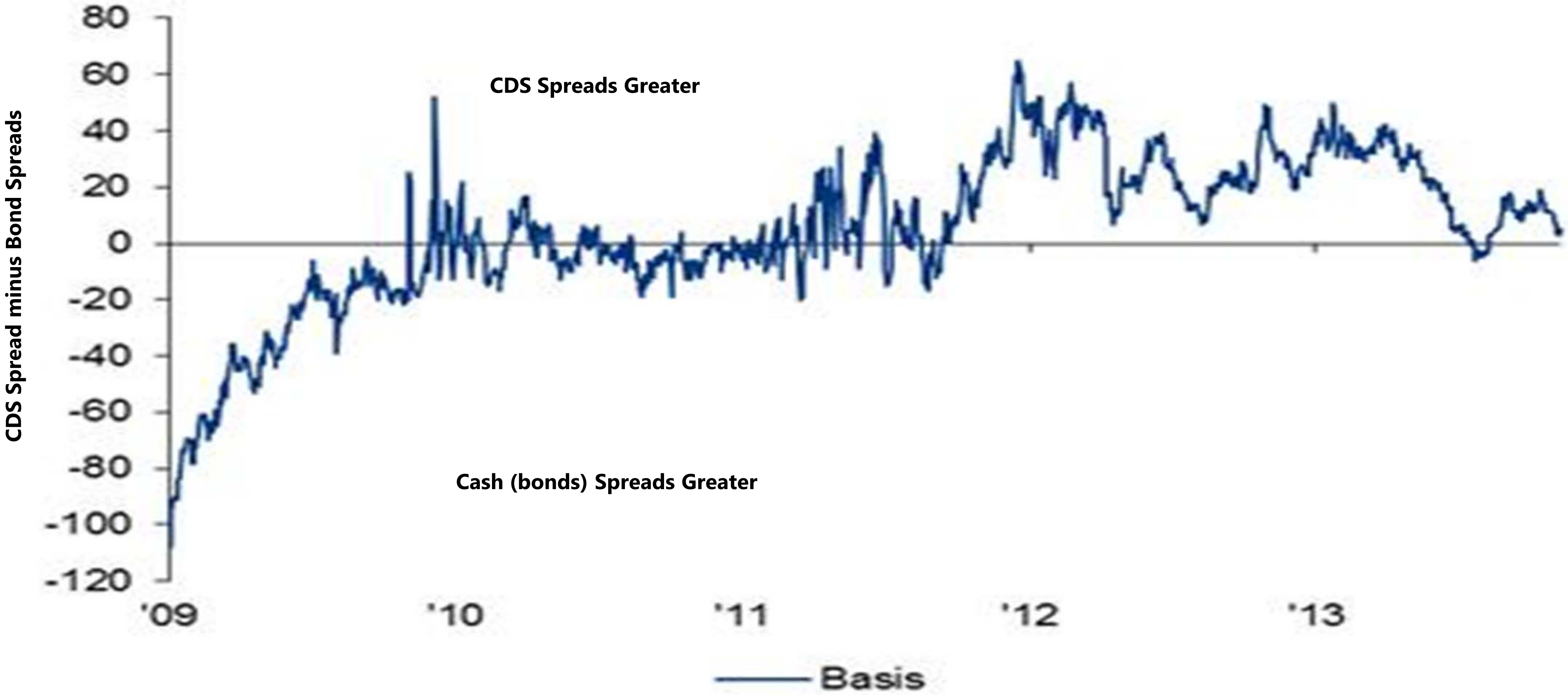
EMBIG Spreads



As of 31 March 2014. SOURCE: PIMCO, JPMorgan.

Institute and Faculty of Actuaries

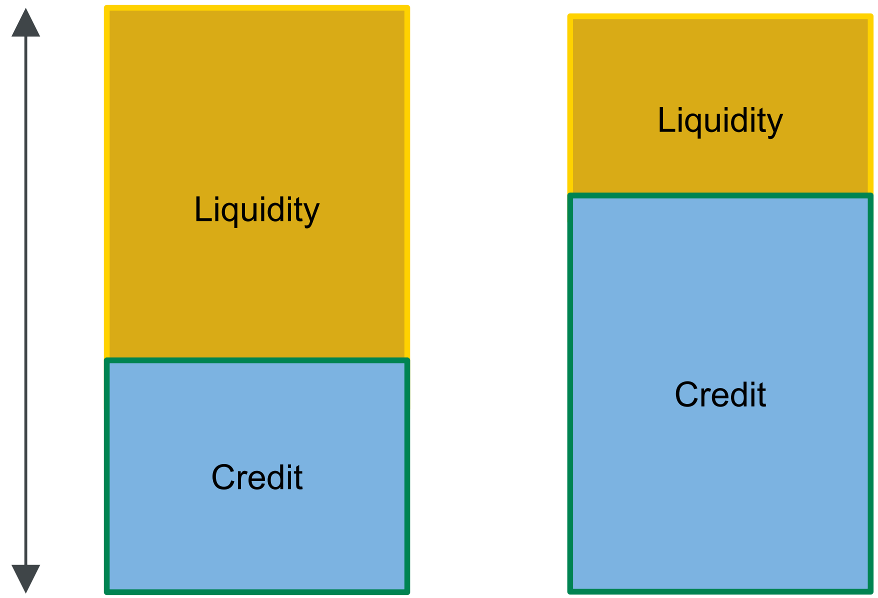
Credit Default Swaps as an Investment Opportunity



Illiquidity in the market

In a sustained low interest rate environment illiquid assets are becoming more and more appealing investments, providing insurers with predictable and stable cash flows over the long term.

- The liability profile of insurance companies make illiquid assets an appealing investment.
- General insurers are often considered to have short term liabilities but the incidence of claim awards in the forms of PPO (amongst other things) increases the amount of long tail liabilities present.
- Further to this, falling underwriting margins gives rise to potential pressure for profit emergence from other sources.
- The highly collateralised nature of certain illiquid assets (e.g. infrastructure) compared with the liquid equivalent implies a lower credit risk and therefore a favorable capital treatment.
- However, the yield on these assets may still be attractive compared to gilts or cash.
- In summary, certain illiquid assets may present an attractive opportunity for general insurers.



Institute and Faculty of Actuaries

The scale of the illiquid asset opportunity

British insurers commit £25bn to UK infrastructure

Friends Life… announces a new £500m mandate … to the commercial mortgage business of Pramerica Investment Management Ltd

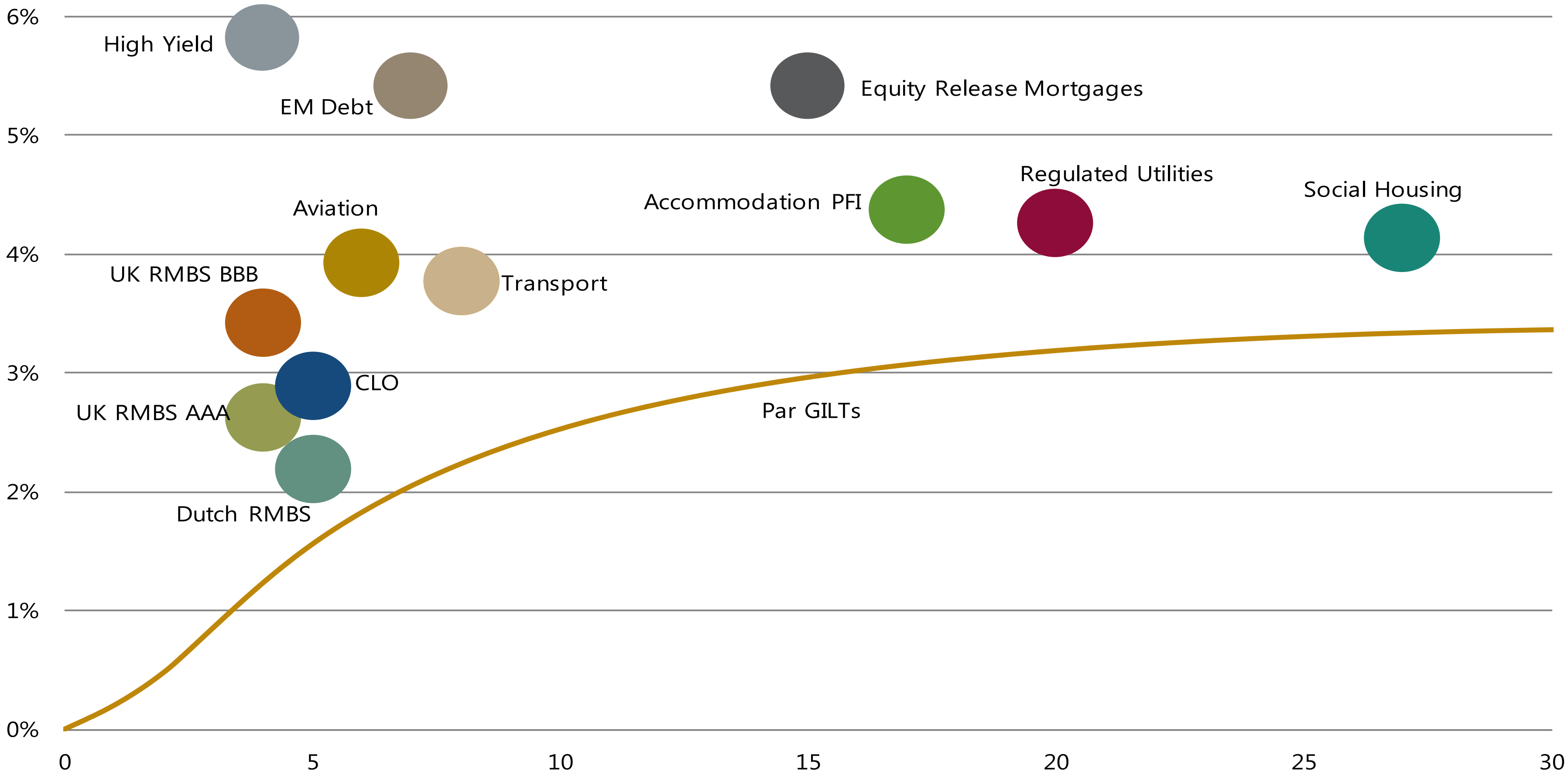
Prudential plans to plough nearly £300m into the construction of around 1,000 new (affordable) homes.

L&G plans to begin lending to larger SMEs

Insurer Aviva has completed the purchase of around 7,000 solar photovoltaic systems, totalling around 23MW

Institute and Faculty of Actuaries

That’s all very well- what are the returns?



As of 31 March 2014. SOURCE: Institute of Actuaries Non-Traditional Working Party, PIMCO
Refer to Appendix for additional investment strategy, issuer and risk information

Institute and Faculty of Actuaries

Institute and Faculty of Actuaries

Future trends

ertise onsorship Thought leadership Progress Community Sessional Meetings Education Working parties Volunteering Research Shaping the future Networking Professional support Enterprise and risk Learned society Opportunity International profile Journals Suppo

Five bold predictions regarding insurers future investment activity - discussion

- Securitizations will make a comeback and P&C insurers will participate
- Infrastructure debt will remain a niche area
- Insurers will grow to appreciate asset liquidity
- Emerging markets have emerged and will continue to increase as a proportion of insurance company assets.
- Insurers will begin to use macro tail risk hedging as a risk and capital management tool

Institute and Faculty of Actuaries

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.

Institute and Faculty of Actuaries