Insurance Company Investment Trends – A Client Survey

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Summary of Survey Respondents

Company Type

- P&C: 73%
- Life: 21%
- Health: 2%
- Multi-Line: 2%
- Other: 2%

48 Total Respondents

Portfolio Size

- Less than $100M
- $100M - $500M: 50%
- $500M - $1B: 10%
- $1B - $5B: 20%
Who is responsible for management of the investment portfolio?

- External Asset Manager: 60%
- Managed Internally: 13%
- Combination Internal & External: 27%
Companies considering outsourcing investment management?

- Yes: 6%
- No: 29%
- N/A - Already Outsourced: 65%
What’s Important When Considering Outsourcing Investment Management?

- Expertise / Ideas: 68%
- Limited Time / Resources: 20%
- Risk Management Tools: 7%
- Cost Efficiency: 5%
Investment management services should go beyond just portfolio management

- Asset Allocation / Risk Asset Analysis
- Dynamic Financial Analysis
- Investment Policy Construction / Review
- Investment Income Projections
- Tax Modeling
- ALM / Duration Targeting
- Cash Flow Testing
- Performance Benchmarking & Attribution
- Liquidity Analysis
- Peer Analysis
- Rating Agency Support
- RBC / BCAR Sensitivity Analysis
- Investment Accounting
- Accounting Support
- Portfolio Acquisition Due Diligence
Which investment objective is most important?

- **Maximize Total Return**: 23% (P&C), 10% (Life)
- **Maximize Income**: 6% (P&C), 20% (Life)
- **Preservation of Capital**: 71% (P&C), 70% (Life)
- **Provide Liquidity**: 0% (P&C), 0% (Life)
Ranking of Investment Objectives

- **Most Important**
  - Maximize Total Return
  - Maximize Income
  - Provide Liquidity
  - Preservation of Capital

- **Least Important**
  - Maximize Total Return
  - Maximize Income
  - Provide Liquidity
  - Preservation of Capital
Which investment risk is most important?

- Credit: 68% P&C, 80% Life
- Duration: 24% P&C, 20% Life
- Other: 9% P&C, 0% Life
Ranking of Portfolio Risks

Most Important

- Credit Risk
- Duration
- Yield Curve
- Call Risk
- Liquidity
- Mark to Market
- Foreign Exchange

Least Important
Industry credit trends – exposure to below investment grade bonds.

P&C Industry

Life Industry

Source: SNL
Credit risk considerations.

Cumulative Default Rates (1983-2014)

- Default rates do not increase linearly as rating is decreased.
- Set portfolio concentration limits that take into account default and recovery rates.
- Consider surplus exposure if Assets to Surplus leverage is high.

Source: Moody’s Annual Default Study (Mar 2015)
Industry duration trends – exposure to 10+ year bond maturity.

P&C Industry

Life Industry

Source: SNL
Duration risk considerations.

- Surplus volatility
- ALM considerations
- Income needs
- Liquidity needs
- Asset Leverage

**Formula:**

$$D_S = (D_A - D_L) \times \frac{A}{S} + D_L$$

- $D = \text{Duration}$
- $L = \text{Liabilities}$
- $A = \text{Assets}$
- $S = \text{Surplus}$

- To immunize surplus from interest rate risk, set $D_S = 0$
  - Then Asset Duration = $D_L \times \frac{L}{A}$

- To set specific level of surplus interest risk,
  - $D_A = (D_S - D_L) \times \frac{S}{A} + D_L$
Which macro-economic risk are you most concerned with?

- Monetary Policy: 37%
- Inflation: 30%
- Slowing Global Growth: 20%
- Deflation: 11%
- Oil Prices: 2%
Which investment risk are you most concerned with?

- Low Yields: 58%
- Rising Rates: 23%
- Equity Volatility: 13%
- Increase in Credit Defaults: 4%
- Credit Spread Widening: 2%
Worrisome trend in corporate market as credit metrics are weakening.

Source: AAM, Capital IQ (Universe includes 451 Industrial companies; Financial data as of 3/31/2015)
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Corporate sector expectations.

PROS:

• Consumer is in a better position to spend
• Job market is improving
• Global demand for yield with limited alternatives

CONS:

• Liquidity is challenging in fixed income
• Fed action should slow (already nonexistent) credit growth
• Event risk remains high with debt funded deals increasing
• Late stage of the credit cycle; Companies acting more aggressively

➔ In this stage of the cycle, focus on liquidity and quality

Source: JPM “Where We Are In The Credit Cycle” 10/14/2014
How do current investment opportunities compare to a year ago?

- The Same: 64%
- Better: 13%
- Worse: 23%
Which risks are you currently willing to increase to achieve a higher yield/return?

- None: 42%
- Credit: 27%
- Duration: 13%
- Liquidity: 9%
- Market: 9%
Risk premiums appear fair.

Source: Barclays
Which non core fixed income asset class have you been adding (or considering adding)?

- Equity: 35%
- Commercial Loans: 15%
- High Yield: 10%
- Convertibles: 5%
- MLPs: 5%
- EM Debt: 5%
- EM Equity: 5%
- Other: 5%
Equity valuations appear fully valued.
Consider Convertibles as an alternative to equities.

Why consider convertibles?

- Equity market exposure
- Downside protection
- Low correlation to traditional fixed income
- Low interest rate sensitivity
- Historically good performance in rising rate environments
- Favorable regulatory and accounting treatment

Convertible issuance has picked up

U.S. New Issue Supply ($Bln)

Source: Zazove Associates, LLC, BAML Global Convertibles Research
Industry trends regarding alternative assets.

- Understand the risks
- Model the tail risks
- Liquidity could be challenging in a higher volatility environment

Source: SNL
Questions?