Alternative investments for insurers in a low yield world

Gerard Moerman, Ph.D.
Chief Investment Solutions Officer

AEGON Asset Management | KAMES CAPITAL | TKP Investments

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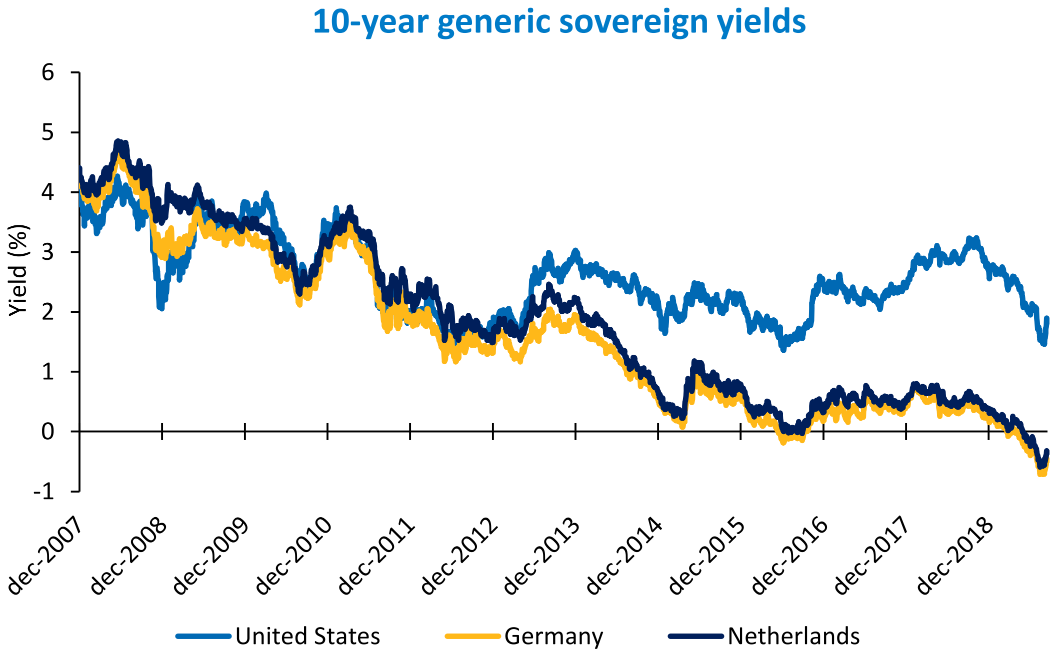
Agenda

- Options for insurers in a low rates environment
- Increasing allocations to illiquid and alternative investments
- Alternative investments offering a better risk and capital-adjusted return

Interest rates remain very low

How to invest going forward?

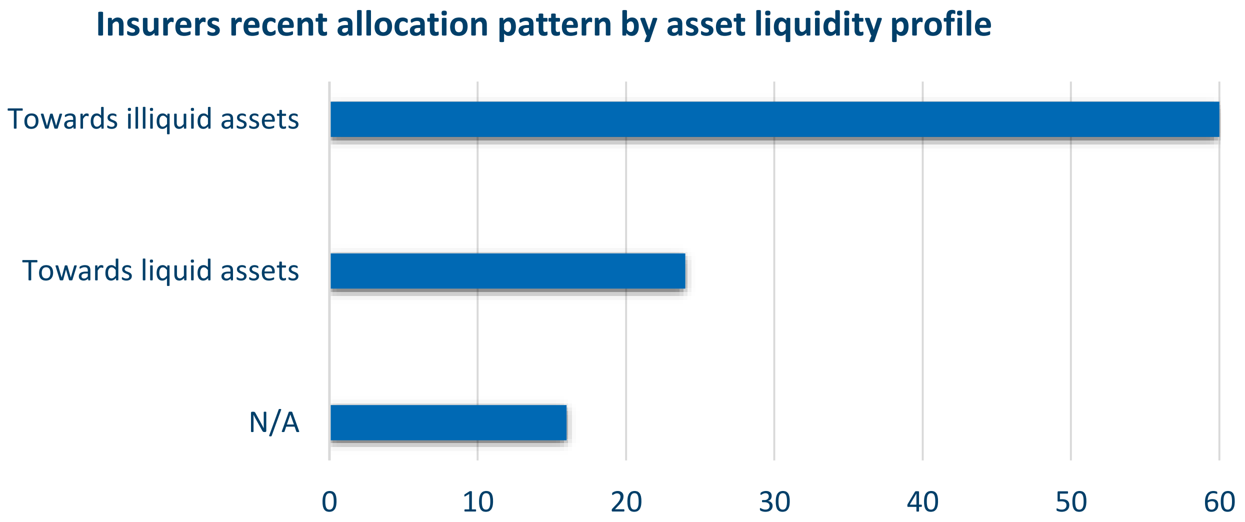


How to invest going forward?

1. **Reduce duration of assets**
2. **Increase credit spread risk**
3. **From beta to alpha**
4. **Illiquid fixed income**

Source: Aegon Asset Management, Bloomberg; 10-year generic yields from 01/10/2007 to 17/09/2019.

Increased allocations to illiquid assets



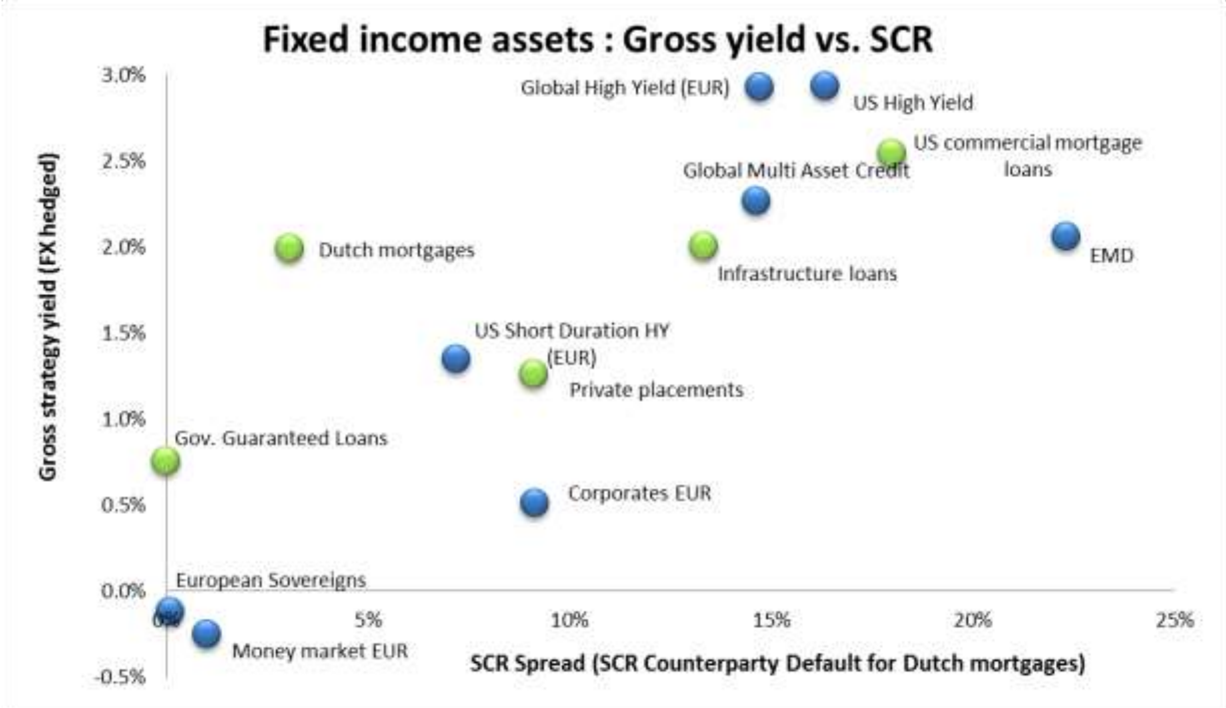
Source: EIOPA (2017). Some 91 insurers were asked "Have you increased your investment allocation towards more illiquid or liquid assets?" Illiquid assets were debt/equity from private non-exchange traded companies, participations in infrastructure projects, hedge funds. Liquid assets were debt, equity, currencies, commodities and assets tradeable in major exchanges.

Range of “natural-fit” strategies for insurance companies

Strategy	Theme	Life	Non-life	Key characteristics
Government-related private loans	Alt. credit	✓✓✓	✓	• Offers a higher yield for similar level of risk of sovereigns
Buy and maintain/CDI	Fixed Income	✓✓✓	✓✓✓	• Bespoke matching solutions
Absolute return bonds	Fixed Income	✓✓✓	✓✓✓	• Low risk and low SCR; capital preservation at its core
Short-dated IG and HY	Fixed Income	✓✓✓	✓✓✓	• Higher yield whilst mindful of liquidity, risk and capital budget
Dutch Mortgages	Alt. credit	✓✓✓	✓	• Low SCR; long maturity, attractive yield and high credit rating
Infrastructure debt	Alt. credit	✓✓✓	✓	• Diversified sources of return; attractive for longer-term liabilities
US Commercial Loans	Alt. credit	✓✓	✓	• Diversified sources of return
SME Loans	Alt. credit	✓✓	✓	• Lower rated/subordinated bank loans; possible with EIF guarantee
European ABS	Alt. credit		✓	• Strong track record; absolute and relative
Alternative Risk-Premia	Multi-asset	✓✓	✓✓	• Transparent and diversified sources of return
Diversified Income	Multi-asset	✓	✓✓	• Transparent with consistent provision of income

Added value in illiquid fixed income assets

Illiquid fixed income assets (green) offers a higher yield for similar amount of credit risk



Sources: Bloomberg, Aegon Asset Management, La Banque Postale Asset Management. September 30, 2019. The bullets in the chart are for illustrative purposes and do not represent exact calculations. Also, the graph does not take the capital charge for interest rate risk into account. Sovereign bonds are Core Eurozone bonds (rating of AA- or better). European Sovereign Bonds and Corporates EUR have ratings of BBB- or better. Gov. Guaranteed Loans have a similar rating as core Eurozone bonds. Private placements are assumed to have a spread of 75 bps over corporate bonds. US Short duration focuses on the 1-3 year BB-B index. with a correction for currency hedging. US High Yield primarily invests in US high yield bonds, but may include opportunistic allocations to investment grade bonds, bank loans, emerging market bonds, and cash / cash equivalents. Infrastructure Loans are represented by the target portfolio (target return of 200 bps over Euribor, estimated weighted average life of 10-12 years). Emerging market debt (EMD) invests in fixed income securities in US Dollars issued by entities in emerging markets. Global Multi Asset Credit invests in asset backed securities, bonds and loans and other fixed income securities issued by governments, government agencies, supra-nationals and companies worldwide. Money market EUR has a weighted average remaining time to maturity of up to one year. Dutch mortgages represents a large mortgage pool with an internal rating of AA and a focus on long fixed-term mortgages (the duration is about 8.5 years). US commercial mortgage loans are unrated loans with a duration of 7 years and an internal rating of BBB, asset-swapped back to euros.

Government Guaranteed Loans

High rated government risk with a decent pick-up

Interesting opportunity for insurers with long liabilities

- Attractive premium compared to liquid government bonds
  - Liquidity risk
  - Complexity risk (legal contracts, non-STP work)

- Many options for impact investment
  - Loans to social housing corporations ("WSW")
  - ECA-loans in e.g. hospitals and renewable energy

Private Placements

Characteristics of the market:

- Invest in USPP, Schuldschein, EUPP, unrated MTNs
- Total volume of the market is €45-€65 bln per year

Reasons to invest:

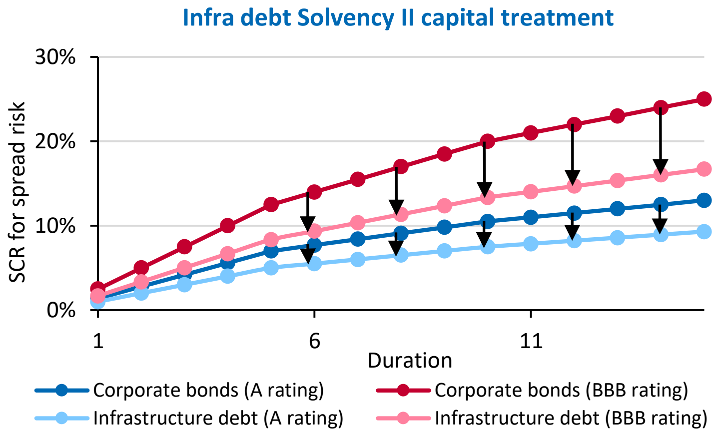
- Pickup of 60-100 bps over liquid credits
- Higher return on capital
- Diversification
- Stronger documentation and grip on ESG

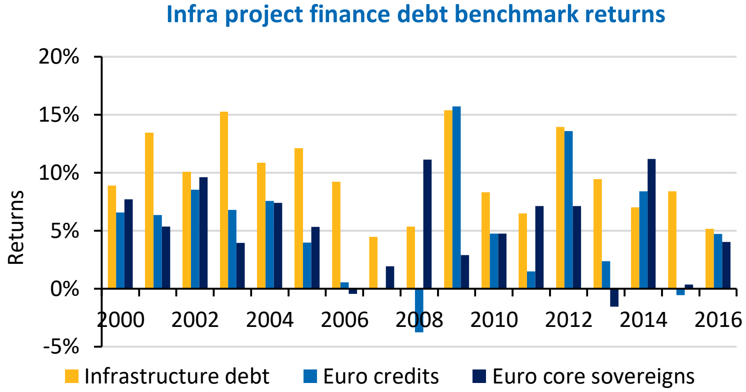
Risk and Return Profile					
Asset Class	**Credit Quality**	**Modified Duration (Years)**	**Yield**	**Expected annual loss**	**Net Yield**
EUR Investment Grade Credits excl. Financials	BBB+	~5.5	0.4%	0.05%	0.35%
AAM’s Corporate Private Placements	BBB	~6.5	1.4%	0.10%	1.30%

Source: Moody’s, Bloomberg

Infrastructure debt

- Infra debt treated favourably under SII
  - However, criteria must be met for inclusion as “infra”
- Strong ESG-focus
  - Many investments needed in renewable energy
- Stable cash flows
  - Strong historical returns





See data/sources from AAM articles: Link 1, Link 2

Conclusion

- Wide and varied number of options for insurers in a low rates environment
- Increasing trend to illiquid and alternative Investments
- Alternative investments can offer insurers a better risk and capital-adjusted return

Appendix: selection of AAM publications

Website: https://www.aegonassetmanagement.com/netherlands/solutions/

Financial impact of climate policy risks

By Gosse Alserda & Menno Altena • September 19, 2019

Why the Danish mortgage bond market is sinking into negative yield territory

By Niek Swagers & David van Bragt • September 10, 2019

Revision of the Solvency II standard formula approach

By David van Bragt & Rémi Lamaud • March 12, 2019

Low yields: Ideas for positioning your fixed income portfolio

By Gerard Moerman & Franck Sega • October 09, 2018

Analysis of infrastructure debt under FTK, Solvency II and Basel III

By David van Bragt & Rémi Lamaud • July 02, 2018

ABS under the microscope

By Niek Swagers • June 19, 2018

Balance sheet management: How much illiquidity can investors handle?

By Sibrand Drijver & Niek Swagers • April 30, 2018 • Published in FI and Pensioen Pro

Appendix: Benefits of short-dated high-yield

Reasons to consider SD HY:

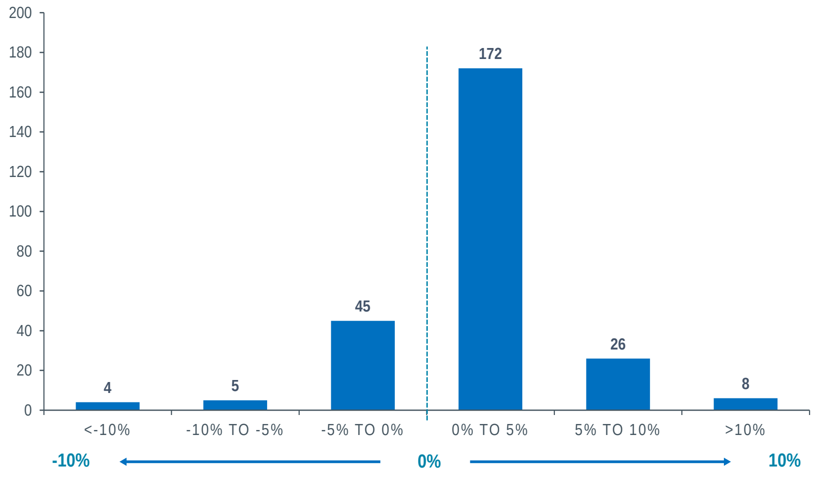
- Diversification into global credit issuers
- Time seniority gives some protection
- Forecastable cash flows

Elements to take into account:

- Economic risk is higher
- Hedge costs (many US names)

Track record of capital preservation

Rolling quarterly returns of BoAML 1-5 year index 1Q97-4Q18



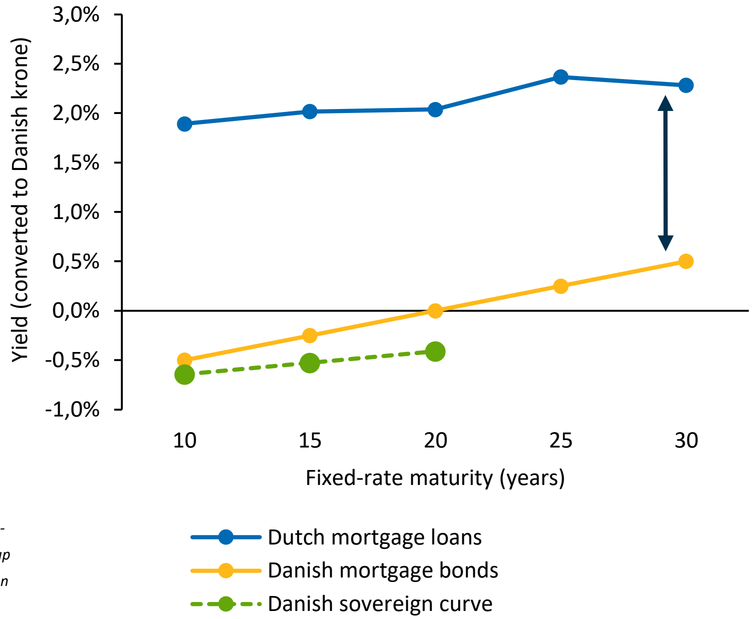
Sources: Bloomberg, BofAML as at December 2018.

Appendix: Dutch vs. Danish mortgage investments

Direct access to Dutch mortgages gives another liquidity premium

- Dutch and Danish mortgage markets are large, well developed and supported by households with (on average) a high net worth.
- Dutch mortgages are direct loans. Investments are typically made via a pool of thousands of mortgages (total size ≈ €669bn).
- Danish mortgage bonds are listed bonds and are actively traded on a secondary market (total size ≈ €363bn).

Comparison of the yields on Danish mortgage bonds and Dutch mortgage loans



Source: Bloomberg, Aegon Asset Management, as of 29 August 2019. We here take the perspective of a Danish investor who has hedged the currency risk of euro-denominated Dutch mortgage loans. Dutch mortgage loan yields are based on Aegon mortgage rates. We assume that 25% of the Dutch mortgages are backed up by a Dutch State guarantee (NHG). For the remaining 75% we assume that the loan-to-value (LTV) is higher than 81%. Yields for Danish mortgage bonds have been based on recent quotes for mortgage bonds: 10 year at -0.5% (Jyske Bank), 20 year at 0% (Nordea) and 30 year at 0.5% (Nordea and Realkredit Danmark).

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